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Political Forces and Highway Finance: The Toll Road Movement

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THERE ARE OBVIOUSLY many political decisions that are affected by economic forces just as there are economic forces affected by political decisions. The whole body of public finance belongs as much to political science as to economics. It may therefore be of interest to an audience primarily interested in economic matters to consider the political circumstances which have revived the toll financing of public roads after a century of suspension. The essential questions at issue are the central problems of all public finance as a political matter: what services shall be provided and how shall the cost of them be distributed.

Considering the mileage and investment in the whole highway system of the United States or even the 38,000 miles of the so-called interstate system, toll road mileage and investment are rather small in scope.¹ The rate of increase, however, is startling. The toll

roads have been spectacular in the very elaborate facilities they offer the motorist, in their cost per mile, in the amount of borrowing which has been necessary to finance them, and in their promotion. They are represented as something different from the ordinary system in design and in convenience of travel as well as in financing and administration.² Their uniqueness is the very essence of their political appeal.

Toll roads are not financed from ordinary highway revenues but from charges paid by users. In many cases they are not built by state highway departments but by separately constituted bodies, usually called authorities. Most highway building, since the first great effort to build the intercity hard road network, has been financed from current revenues. Toll roads are to be built from the proceeds of long-term bonds which, in effect, capitalize future revenues. They are to be built only on routes with high-density traffic which require very expensive divided lane construction, with controlled access, and the elimination of grade-level

¹ Exclusive of city streets there were 642,000 miles of roadway in the Federal-aid primary and secondary system as of June 30, 1949 (United States Department of Commerce, Bureau of Public Roads, *The Local Rural Road Problem*, 1950, p. 6). Toll roads in operation November 1, 1953, totaled 809 miles. Another 1,083 miles were under construction, and 3,106 miles had been authorized. More than \$2 billion was spent or committed for work already begun, and \$3 billion was projected for the authorized mileage (United States Chamber of Commerce, *A Dynamic Highway Policy*, Washington, 1954).

² See J. K. Knoerle and Associates, *A Toll Road Program for the State of Illinois*, pp. 4 and 16 on the last point. Construction costs are estimated at \$2.35 million per mile for the Chicago belt route and \$1.1 million for routes in less congested areas. In other states costs have run from half a million dollars per mile to \$2 million, with urban sections costing from \$6 to \$8 million.

crossings, and which presumably offer the revenue to pay for the enterprise.

In several ways this is a decided departure from previous highway policy and it has met a consequent resistance from highway officials. Highways have been public facilities ever since their modern re-emergence as an important part of the transport system, free to all who could use them from tramp to ten-axle tractor and trailer. They could be entered at any point or left at any point open to the user. Tolerable facilities have been provided on routes low in traffic as well as on the most densely traveled metropolitan routes. They have been a flexible device to serve the need for movement of all members of the community who had the means to use them. It is true that highways have been financed to an increasing extent, locally as well as state-wide, by user taxes on motor vehicle fuels and on vehicles. But except for some of the more recent developments in the taxation of commercial users, there has never been a convincing claim that taxes paid and vehicle use were closely related. The bookkeeper who drove his car on city streets on Sunday and the salesman who scoured the state for business five days a week paid the same vehicle tax. Even though the bookkeeper's gas tax was lower, a smaller proportion of it was devoted to the particular roads he used.

It is ordinarily characteristic of governmental services that they are intended to benefit the whole community and that their importance is not limited to their direct recipients. It is also characteristic that, with notable exceptions such as municipal utilities and improvements financed by special as-

essment, they are financed by tapping the wealth of the community at points other than those at which the service is dispensed. The whole tendency of modern budgetary reform has been to bring the various expenditures of government together, and to evaluate them according to their relative necessity and desirability within whatever total of public expenditures was thought to be defensible. On the revenue side the doctrine has been to treat, so far as possible, all revenue sources as available to meet all expenditures and to minimize segregated revenues and separate funds. In the field of highway revenue this tendency has operated despite opposition. The gas tax revenue has been repeatedly "diverted" by the states and even by the national government, which returns less to the states in highway construction grants than it receives from motor vehicle fuel taxes and other excises on vehicles and parts.

The free road policy (the availability of highways to many classes of users without toll charges), which conforms to the conditions under which governmental services are usually provided, has been so persistent that an elementary principle of political analysis can be invoked to conclude that there must be strong groups which support it. Opposition to established highway policy draws its leadership primarily from those who compete with highway transportation. Where such an established policy has been so consistently successful in the face of strong opposition, any modification of the policy must be due to even stronger political forces behind the new policy development.

The origin of the challenge to ac-

cepted policy probably lies in the changes, relative to the design of existing highways, in the total volume and density of traffic and in types of vehicles and their uses. Many people regard the present structure and level of maintenance of our highways as almost catastrophic. The situation results in part from the cycle of highway building. Original construction was largely carried out within one decade, and highway expenditures were subsequently cut by depression and war, so that the original pavements are largely worn out or of obsolete design. Construction which would meet contemporary needs did not proceed at a steady pace, and the resulting wear and obsolescence in the original system seem to have come on us all at once.³

As a result, there has developed a demand for a new order of highways exceedingly costly to construct.⁴ The

³ In Illinois miles traveled by vehicles on the state system rose from 11 billion in 1930 to 27 billion in 1950. Vehicle registrations rose from one vehicle for each 4.7 persons in 1930 to one per 3.3 persons in 1950. Commercial traffic increased 140 percent in the 1936-50 period against a total increase in traffic of 87 percent. Single-axle trucks increased 97 percent in number from 1936 to 1950; tractor-trailer units, 238 percent; axle loads for semi-trailers from an average of 11,500 pounds to 14,400 pounds; and truck-trailer combinations from 9,600 to 15,600 pounds (State of Illinois, Department of Public Works, Division of Highways, *Present and Future Improvement Needs of the Primary and Federal Aid Secondary Highways Systems*, April, 1951).

⁴ The Bureau of Public Roads in a report to Congress, *Highway Needs and the National Defense* (81st Congress, 1st Sess., H. Doc. 249) probably opened the public campaign for greatly increased expenditure. In that report they estimated that of the 37,800 miles in the interstate system only 1,900 miles of the rural section and only 398 miles of the urban section required no

projected figures amount to a staggering sum. The most vocal proponents of the expenditures are probably the state and Federal highway officials, supported by the President on the ground of national defense and economic development. But it is unlikely that such backing would have developed if there were not elsewhere in the political picture growing support for highway expenditures. The simple absence of concurrence between human aspirations and the facilities available for them does not automatically lead to politically effective demand. Housing and schools are cases in point. Support for a greatly expanded highway construction program has come from highway users such as the National Conference of Highway Users, from the petroleum industry, the automotive industry, highway builders and their

immediate work. Seventy-seven percent of the remainder required the most expensive type of improvement, that is, reconstruction on the existing right of way or relocation. The estimated cost of improvement was \$11.27 billion. (The interstate system is a national net selected because of its presumed importance in time of war. It carries the highest traffic load of any highway mileage.) The most recent proposal is for a \$25-billion expenditure on this system, all of it from the Federal treasury. In 1953 the completed and projected toll road mileage was about 10 percent of this system, but the total of costs and commitments was over \$3 billion, or more than one-fourth of the 1949 estimated cost of improvements (H. E. David, R. A. Moyer, N. Kennedy, and H. S. Lapin, *Toll Road Developments and their Significance in the Provision of Expressways*, Institute of Transportation and Traffic Engineering, University of California, Research Report No. 1, 1953, p. 12). The authors use this toll road expense to show the degree to which the earlier figure underestimated costs of needed improvements on major traffic arteries.

materials and equipment suppliers, and from the organized motoring public.⁵

One might think that a well-financed and organized campaign for greatly increased highway expenditures, with the general public made receptive by accounts of accidents and their own experience of inconvenience, would easily be effective. (If it were, the demand for toll roads would probably not have developed.) However, there are obvious difficulties in the realization of a general program of highway building. It is in financing that obstacles are encountered. Rapid building requires borrowing, since currently available revenues in most states will not permit a greatly expanded program of construction.⁶ Borrowing is greatly restricted in state constitutions so that in most states either a constitutional amendment or a referendum is required to allow borrowing for anything except emergencies. The constitutional provisions are the evidence of a political movement in opposition to free resort to borrowing by the states. The successors of those who wrote the provision stand alert to check any movement to lift the debt limit. In this connection it may be said that the fiscal activities of the states are far more closely restrained by taxpayers' groups

than are the fiscal activities of the national government.

A slower rate of construction could of course be supported by increased taxes. Presumably these would be levied on the same sources which now supply the bulk of highway revenue — motor vehicles and motor fuel. Any proposal to use general revenue would encounter insurmountable opposition. But the difficulty in securing a substantial increase in highway revenues is almost as great, despite the fact that those who pay these revenues are also the principal supporters of increased road expenditures. If highway users are relatively united on the need for improvement, they are not at all united on who will bear the costs, nor upon the parts of the system which should have priority in the expenditure of funds. The possibility of an increase in vehicle license fees occasions intense conflict between the private motorist and the various classes of truck owners and operators regarding the share to be contributed by each. Proposals to increase gasoline taxes not only encounter the opposition of the oil industry, which has both impressive size and a wide geographic distribution of its jobber and retail members, but they become involved in the struggle between the various governmental units over the share of increased revenue each should get. Each unit is supported by that part of the highway public which uses the roads it builds or by those taxpayers who hope to avoid tax increases (or even to enjoy tax cuts). The railroads and their allies enter into some phases of this complicated struggle in support of the general proposition that their trucking competitors should pay their own way.

⁵ See *Roads and Streets*, January, 1953, p. 68, and May, 1953, p. 58, for brief discussions of the campaign for better roads by highway officials and the National Conference of Highway Users.

⁶ The 1951 study in Illinois, cited in note 3, projected improvements requiring \$928 million to be completed by 1960. The 1954 construction program of the department, using all available highway funds, state and Federal, projected only \$71 million of construction for that year, at least \$20 million less than a proportionate annual share of the ten-year program.

Under these circumstances the possibility of financing a greatly increased road program by taxation is severely limited. The apparently irresistible force of those wanting the program is shattered by their disagreement over the distribution of costs and the priorities of expenditures. Out of this circumstance develops the strength of the toll road movement. At least a part of the support for highway building can be diverted to the toll road program while the obstacles to general highway construction which result from disagreements over conventional means of financing are avoided. Two features, revenue bond financing and the imposition of tolls, help to isolate the toll road program from the struggles that enmesh proposals for the expansion of free roads. It is or should be a truism of political analysis that any political demand, unopposed, is effective once starting friction has been overcome. Revenue bonds escape not only constitutional restrictions but the opposition of those who fear that present borrowing may result in future tax increases. Present taxes are avoided by tolls which will presumably retire the bonds within the projected life of the improvement. The future toll payers are apparently not so conscious of their fate, or so opposed to it, that they have emerged as a political group.

It is easy to see, therefore, why toll roads have been authorized in so many states within the last few years. They offer a means of accommodating a portion of the demand for vastly increased highway facilities without arousing the opposition that increased taxes would occasion. This does not mean, however, that they will not arouse their own

characteristic opposition. Developments in Illinois are probably illustrative rather than peculiar to the situation in that state.

New highways without grade separations will also carry with them restrictions on access and on roadside development that so far have affected only a small part of existing free mileage. They will not provide the same opportunities for motels, filling stations, restaurants, and the many other enterprises which win a living from highway traffic. (Some states, notably Pennsylvania, have treated such enterprises as a state monopoly with sites leased out to provide a maximum income to the toll road authority.) Successful toll roads will also divert traffic from existing roads to the detriment of existing highway business. The oil industry is already afraid of the restrictions on retail outlets which toll roads may impose. In Illinois there has also been strong opposition from property owners faced with the loss of much profitable land which the new routes with their divided lanes, wide shoulders, and cloverleaf intersections require. Groups supporting the free road program are less active as yet, chiefly because they are not united. However, the trucking industry and the motor clubs, nationally at least, actively oppose the toll road program. The gain in new road mileage by toll financing is apparently less important to these groups than the threat to the existing roads, especially those parallel to toll routes, which may suffer from neglect and the diversion of funds.

Those who study a given political development are not necessarily the better equipped to make judgments with respect to its desirability. But an

author is not thereby debarred from the luxury of judgment open to others. Is the toll road movement a desirable and defensible addition to highway fiscal policy? It has surface justification in the contributions it will make to highway mileage and in its method of financing, which places the costs on the shoulders of those who benefit.

Is it possible to criticize such a development on any other grounds than that it is a departure from an established policy, and therefore mildly unsettling, or that it will take something away from those who currently get more highway service than they pay for? It seems to this writer that it is.

The most general criticism is that toll road development imposes limitations both of planning and of movement on what has otherwise been a very flexible system of transport. To create a dual system of highways, one of which is subject to charges and one of which is not, is to impose an additional condition governing movement. Not only is this true of the imposition of charges. It is also true of layout. Access to toll roads must be limited not only by the traffic considerations which govern all expressways but by the requirements of economical toll collection. Those who travel between points not directly served by the system must either move on and off it in a relatively inconvenient way, or use parallel facilities. In the one case this adds to the costs of the user, in the other it adds to the total investment in highway facilities to accommodate a given volume of traffic. Since toll roads are feasible only in areas of dense traffic, parallel facilities are inevitable, and the need of spanning or paralleling the toll

road will add to the expense of providing them. The toll road is a physical as well as a cost barrier to free movement.

High traffic density roads, except where they serve the state leg of an interstate movement, cannot exist in isolation. Their high traffic counts are built up from the flow of less traveled roads. Many travelers will go but a portion of their journeys on the major route. To provide adequate facilities only on the high traffic roads is to provide for only a small portion of traffic needs. The high traffic roads must provide not only the revenue which is needed to construct them, but also the revenue needed to construct routes with less traffic, if the whole highway system is to be self-supporting.

Toll roads, by definition, will provide only the revenue needed to construct the high density facility. They will not return revenue to the general system. By accepting tolls, motorists who use through routes expect to avoid gas tax increases. Without such increases the great mileages that are not fitted to toll road operation can scarcely be improved. As a portion of the highway user group gets its own needs met by a separate toll system, their support for improvements for the whole system is lost. It is like the movement of prosperous householders to the suburbs. Their interest and their taxes are lost to the metropolitan center, on which, however, their livelihoods still depend.

Finally, the speed of toll road construction which bond financing permits can create such demand for all of the facilities of construction — engineering talent, skilled labor, materials and equipment, and the services of experi-

enced contractors — that the standard program, operating without comparable revenue advantages, cannot effectively compete. In a time of high construction activity, a sudden increase in construction is almost bound to cause a rise in costs. The privileged toll road authorities can afford it. But the hard-pressed highway departments are not likely to be able to meet the competition.

The peculiar powers of toll road authorities which develop from the divorce of toll road finance from general state finance lend themselves to unwise planning, if not outright abuse. Revenue bonds cost more than bonds secured by the general credit of the state, since revenue enterprises are speculative in character. Budgeting and appropriation controls are apt to be relaxed since those who provide toll revenues will not easily find the political representation afforded taxpayers. The convenience of underwriters rather than engineering schedules must be considered in the floating of bonds, which may result in interest charges being assumed before borrowed money is actually employed in construction. The awarding of contracts is not always required to go by the standard competitive bidding procedure, and is less subject to scrutiny, since taxes are not directly affected. There is the disadvantage of a practical though not a legal contingent liability on the part of state governments to provide the costs of debt service should revenues or costs vary from expectation.

It is generally thought that the scrutiny of underwriters will serve to assure the soundness of toll road projects. This is, of course, no protection against undue costs since, so far as the roads have a monopolistic character,

they may still be sound investments though costs are high. Moreover, not every bond issue handled by respectable underwriters has turned out to be a sound investment.

There is a certain similarity between the political position of activity which is to be financed by an independent source of revenue and the economic position of a monopolistic or semi-monopolistic industry. The competing demands for tax dollars in the general processes of budgeting and appropriations tend to ensure a distribution of resources with regard to a wide variety of claims and to enforce some economies in their use. This is true even within the already somewhat segregated system of highway revenue and expenditure since there is a wide variety of claims within the field. The competitive demands of our political system constitute one of the elements which assure sanity in governmental operations.

With the development of self-liquidating finance, one segment of the highway system is permitted to develop independently without regard to more general needs or considerations other than those which immediately affect the possibility of self-liquidation. Elements which make for high costs are an inherent feature of the arrangement, since the more the enterprise is monopolistic and, therefore, assuredly self-liquidating, the fewer protections there are against excessive cost. Calculations based on the assumption of continued isolation of the enterprise generally prove to be faulty in the end. The investor does not get the benefits of complete monopoly nor society of competition.

If toll roads were really competitive

enterprises they would not be fit subjects of governmental operation. But it is a mistake to assume that toll roads share the characteristics of competitive enterprise. They seem to be so only in the somewhat misleading feature of revenue financing. As quasi monopolies, to which the government provides its own competition in the free highway system, they are likely in the end to be wasteful of resources.

These are the reasons why highway officials and many organizations of highway users are not enthusiastic about toll financing even though some of them regard it as a partial means of satisfying the demand for high-cost, high-standard mileage.

The disadvantages of toll road financing are, of course, inherent in the situation out of which the demand for toll roads grows. It is to avoid the competition for the tax dollar that toll

financing is born. It is to ensure that a few routes to serve high-density, high-speed traffic are built that the toll road authority is set up. It is the divorce from political competition that enables a particularly favored project to be built at all, and to be financed by a special revenue source which does not need to be shared with any competing demand. It is the reliance on revenue financing that disarms possible critics of either planning or execution. Whether the possible disadvantages of such administrative, political, and fiscal isolation outweigh the very solid achievement that the resulting road mileage represents is a question of judgment, not of science. In the author's opinion, while the toll road solution avoids a very complicated problem of adjusting competing demands for highway facilities, it carries with it disadvantages that are very great indeed.

The Proposed AFL-CIO Merger

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EVER SINCE a group of dissident unions withdrew from affiliated membership in the American Federation of Labor in 1935 and formed the Committee for Industrial Organization, the public has been aware of the existence of a divided labor movement. Strictly speaking, however, there has never been a united House of Labor in the United States in the sense of all organized workers being affiliated with one big top federation such as the AFL. A sizable segment of organized labor in this country has never chosen to affiliate with a top-ranking parent federation. The Railroad Brotherhoods are an example. But the big split in the labor movement has been popularly (and correctly) associated with the formation of the CIO in 1935. Now, after almost exactly 20 years, a merger of these two divisions of the organized labor movement appears imminent. What are the implications of such a merger? What are the motivations for, and the objectives of, such a merger? Are there reasons more compelling now than in the past, and if so, are these reasons primarily economic, political, or personal in character? Does the proposed merger contemplate a real organic union or merely a "paper" or "political" one? What are the prospects for success, and what are likely to be major continuing problems in the current effort to unite the House of Labor? These questions puzzle the public and

challenge the student of industrial relations to probe for appropriate answers.

The Background

The inability of the proponents of industrial unionism, such as John L. Lewis and the late Sidney Hillman, to get the AFL leadership to endorse the principle of industrial organization in the early 1930's provided the immediate impetus for the split in 1935. The older, conservative AFL leaders such as the late William Green and the late "Big Bill" Hutcheson, had clung tenaciously to the principle of craft unionism as originally espoused by Samuel Gompers. In doing so, the AFL had failed completely to organize the vast army of workers in the mass-production industries such as steel, automobiles, textiles, meat-packing, and oil. Disgusted and impatient with their repeated failures in the annual conventions to get the principle of industrial unionism accepted by the AFL as the basis for organizing the workers in the mass-production industries, the dissident group, headed by Mr. Lewis and Mr. Hillman, decided that the only way to force the issue was to withdraw temporarily from the AFL and proceed with their own organizing campaign.

The original "secession" in 1935 was, therefore, relatively small in number and temporary in conception. The seceding unions were the United Mine Workers; Amalgamated Clothing Work-

ers; United Textile Workers; Hatters, Cap and Millinery Workers; Typographers; International Ladies' Garment Workers; Mine, Mill and Smelter Workers; and the Oil, Gas and Refinery Workers. These groups comprised a total membership of fewer than one million out of a total affiliated AFL membership of three million. The temporary nature of this "secession" was indicated by the new title of "Committee for Industrial Organization." The first reaction of the AFL to this withdrawal was a threat of immediate expulsion for the offending unions unless they promptly returned to the fold. And this threat was actually carried out in 1937 when the dissident group was formally expelled from the AFL. The new CIO quickly retaliated by setting up a more formal and permanent organization, naming it the "Congress of Industrial Organizations." The issue was now firmly joined and the split solidified.

The phenomenal success of the CIO, after its early trials and setbacks in the organizing campaigns of 1936-37, is common knowledge and needs no elaboration here. Suffice it to say that as success after success crowned the efforts of the CIO in organizing the mass-production industries of steel, automobiles, meat-packing, and farm equipment, the split with the AFL widened and deepened and the prospects for uniting the labor movement got dimmer and dimmer. Jarred out of its lethargy, the AFL launched its own intensive organizing campaigns and established many parallel rival unions to meet this new competitive menace. This is not to imply that all talk or thoughts of merger were nonexistent in

these early years of the CIO. Repeated conferences were held among the rival leaders and proposals and counterproposals were made, but little, if any, progress was made toward a real reconciliation of differences.

The war years brought a sort of forced truce between the rival factions, as the heavy hand of governmental authority compelled a considerable amount of cooperation between them. But the government did not attempt to force a merger in the labor movement during these years. On the contrary, the government gave full recognition to each side in such wartime agencies as the War Labor Board, the War Manpower Commission, and the War Production Board. Both the AFL and the CIO took advantage of the favorable wartime environment in organizing the unorganized and both federations emerged from the war period with spectacular gains in membership, power, and prestige.

The President's Labor-Management Conference in the fall of 1945 did little or nothing to further the cause of peace between labor and management or unity between the AFL and CIO. But the wave of industry-wide strikes in the fall and winter of 1945-46 did a lot to crystallize public opinion against organized labor. Labor received a severe shock in the restrictive state labor relations legislation of 1946-47 and the Federal Taft-Hartley Act of 1947. No strong pressure, however, for closing the ranks of organized labor to meet this loss of public favor emerged at that time.

In July, 1950, the sixth formal attempt at reconciliation of the two federations was made when the first

talks on this subject in three years were undertaken. Two events in the latter part of 1949 and the first part of 1950 had paved the way for this new effort. One was the courageous action of the CIO in expelling 11 Communist-dominated union affiliates, which greatly increased the acceptability of the remaining conservative CIO unions by the AFL. The other event was the co-operative action of the AFL and the CIO on the international front when they joined ranks at the 1950 meeting of the International Confederation of Free Trade Unions to fight the Communist-dominated World Federation of Trade Unions. The 1950 unity talk brought the two organizations closer together than ever before, and resulted in the establishment of a permanent AFL-CIO Unity Committee. This committee was charged with the responsibility of keeping at the task of unification until it was actually accomplished.

The outbreak of the Korean War in 1950 brought some further action on the part of the CIO and the AFL in the direction of unity, if not of merger. This was the formation of the United Labor Policy Committee. Its function was to present a united organized labor front in dealing with national political and administrative problems, primarily those connected with the prosecution of the Korean War. This joint committee was fairly effective in presenting a united labor front at the national level in dealing with such problems as wage and price stabilization and production controls. But with the sudden withdrawal of the AFL in 1951, this committee was disbanded.

Two unrelated but important events in the fall of 1952 increased the pres-

sure for, and the prospects of, a merger of the CIO and the AFL. The first was the election of Mr. Eisenhower as President, with organized labor generally supporting Mr. Stevenson, and the second event was the deaths of Philip Murray, president of the CIO, and William Green, president of the AFL, on November 8 and 20, 1952. Death or retirement had by 1953 also removed several other old-time conservative AFL leaders such as "Big Bill" Hutcheson of the Carpenter's Union and Dan Tobin of the Teamster's Union. A new top echelon of labor leaders emerged in the labor movement. George Meany succeeded William Green as president of the AFL and Walter Reuther succeeded Philip Murray as president of the CIO. Other new names were added to the top power units with the rise of David Beck as president of the Teamster's Union (AFL) and David McDonald as president of the Steelworkers (CIO).

The AFL and CIO annual conventions in the fall of 1953 were noteworthy in several respects, not the least of which was the strong sentiment evident in both conventions for a unified labor movement. Both conventions went on record as approving a no-raiding agreement between their respective affiliated members, and this pact was put into effect in 1954. The approval of this no-raiding pact by 94 affiliated unions of the AFL and CIO in 1954 has been called "the first constructive step toward labor peace and a united labor movement since 1936." Certainly its importance in the drive for labor unity cannot be underestimated. Thus by the end of 1954, the stage appeared to be set for a really

earnest effort to effect some kind of formal merger of the rival federations. It was in this atmosphere of "now or never" determination that the top leaders of the AFL and the CIO met in Miami, Florida, in February, 1955, to work out the details of a proposed merger.

The Current Proposal

The 22-man negotiating committee, headed by Mr. Meany of the AFL and Mr. Reuther of the CIO, wasted no time in getting down to business and in an incredibly short time came up with a signed merger agreement. The document that emerged was no broad, pious statement on unity, or intent to merge, but a carefully drafted document with a specific formula for organic amalgamation. The written agreement itself is relatively short, with six major sections. Starting out with a statement on "Principles of Merger," Section 2 specifies that each affiliated union in the AFL and the CIO will retain its charter, integrity, and organizing jurisdiction in the merged federation. In those areas where conflicting and duplicating organizational jurisdictions result, the affiliates of the merged federation will be encouraged to eliminate such conflicts and duplications by voluntary agreement. Formal recognition is given to the principle that "both craft and industrial unions are appropriate, equal and necessary as methods of trade union organization." The merger "principles" conclude with strong statements against race or color union discrimination, corruption, and communism in the new merged federation.

Section 3 of the agreement spells out the new government and structure of

the merged federation. Basically, the CIO becomes a department of the AFL under this provision. It is proposed to establish a Council of Industrial Organizations, parallel with the other departments in the existing AFL setup. This new council, or department, is to be open to all industrial unions within the merged federation. Another new department called the Department of Organization is provided for within the merged federation, and this department is to be headed by a Director of Organization chosen from the present ranks of the CIO. The new president and secretary-treasurer of the merged federation are to be elected at the regular conventions and initially they are to be elected from unions now affiliated with the AFL. The biennial convention is to be the supreme governing body of the new federation.

Section 3 further provides that there shall be 27 vice-presidents elected at the regular biennial conventions. These vice-presidents, with the executive officers, shall constitute the executive council. Initially, 17 of the vice-presidents must be chosen from unions now affiliated with the AFL, and 10 from unions now affiliated with the CIO. An executive committee is also provided for, consisting of the executive officers, plus six of the vice-presidents. Initially, three of the vice-presidents for the executive committee must be selected from AFL unions and three from CIO unions. Finally, a general policy board is to be established consisting of the executive officers, members of the executive council, and the presidents of each affiliated union in the new federation. State and local central bodies are

to be continued as structural units in the new federation but are to be merged by negotiation and agreement within two years after the merger of the two top federations is consummated.

Section 4 of the agreement provides for the transfer of all the assets and liabilities of the AFL to the merged federation, and for the transfer of a proportional (to membership) amount of the assets of the CIO to the merged federation. The remaining CIO assets are to be transferred to the proposed Council of Industrial Organizations in the new federation. This section also provides for financing the merged federation by a per capita tax of four cents per member per month.

Section 5 provides for the preservation and continuance of the AFL-CIO no-raiding agreement for a period of two years, and for the continuance of the separate internal AFL and CIO jurisdictional disputes settlement machinery until a new joint committee has worked out an agreement covering both no-raiding and jurisdictional disputes settlement in the merged federation.

Section 6 sets out the procedure for effecting the merger. This procedure includes approval of the merger agreement by the executive councils of the AFL and the CIO, drafting of a proposed constitution for the new federation by the Joint AFL-CIO Unity Committee, submission of the proposed constitution to the executive councils of the AFL and the CIO for approval, and then submission to separate conventions of the AFL and the CIO. Upon approval by the separate conventions, a joint convention of the two

federations will be held and the merger will be officially launched. A final provision is made in Section 6 for the merger and integration of the staffs of the AFL and the CIO into a single staff for the merged federation.

Unless special ratifying conventions are called, these procedural requirements will not be met before the late fall of 1955. These final steps, however, may turn out to be little more than formalities, and for all practical purposes, the merger may be said to have been actually achieved with the signing of the Miami agreement on February 9, 1955.

Reasons for Merger Now

Some of the basic reasons for the proposed merger have been implied in the foregoing review of the events leading up to the merger agreement. The compelling incentive to merge now, regardless of obstacles and costs, may be said to rest upon political, economic, and personal considerations. Far outweighing all other factors in importance in the current drive for "merger now" are the political considerations. The political and legislative reverses suffered by organized labor since 1945 have made an indelible imprint upon the minds and thinking of the new top AFL and CIO leaders, if not on the rank-and-file membership. They have become acutely aware of the fact that not a single piece of significant favorable labor legislation has been enacted at either the Federal or state level since the late 1930's. (This ignores the recent amendments to the Fair Labor Standards Act in 1949 and the Social Security amendments of 1950-54.) On the contrary, the growth of restrictive

labor legislation at both Federal and state levels in the past 15 years has been a source of real alarm to both AFL and CIO organizations. Consequently, the top leadership of both AFL and CIO has become thoroughly convinced that the political effectiveness of their organizations at the polls and in the legislative halls has been drastically reduced by labor's civil war and that the only way to stop this loss of political power and prevent further reverses in this area is to merge now.

Economic considerations, however, were by no means unimportant in the incentives for immediate merger. The organized labor movement came of age in the ten years from 1935 to 1945. In the early years of that decade the existence of rival and competing federations was looked upon by many people, inside and outside the labor movement, as a desirable and healthy situation. But by the end of World War II the tremendous job of organizing the unorganized in the mass-production industries had largely been completed. There were no more great unorganized areas to be easily exploited. Consequently as organizing campaigns diminished in force and as the membership stabilized after World War II, attention shifted more and more to the raiding of one federation's membership by the other. When activity thus shifted from organizing the unorganized to squabbling over the already organized, hard-headed business considerations dictated that something be done to eliminate internal strife. Furthermore, it was realized both by AFL and by CIO leaders that organizing the unorganized was becoming increasingly difficult as a result of this jurisdictional conflict.

This was the immediate impetus behind the no-raiding pact of 1954, from which it was a fairly easy step to the merger agreement of 1955.

Another economic motivation for merger stemmed directly from the 1950 action of the CIO in expelling some 11 affiliated national unions as being Communist dominated. The direct result of this expulsion was the loss of approximately one-third of the CIO membership with a consequent serious loss of financial strength. Furthermore this expulsion not only greatly increased the desire of the CIO to merge with the AFL, but greatly increased the acceptability of the CIO to the AFL.

Finally, there were personal considerations in the drive for immediate merger in 1954. As we have noted earlier, the passing of the old AFL and CIO leadership by death or retirement had by 1954 removed one of the major barriers to labor unity. The new top echelon of labor leaders were not handicapped by the old personality conflicts that had so long been a barrier to labor unity. The old "theoretical" issue of craft versus industrial unionism had long since ceased to be a major consideration keeping the two federations apart. Mr. Meany and Mr. Reuther are firmly convinced that the future welfare of the labor movement lies in merger rather than rivalry. With the failure of Mr. Lewis in the spring and summer of 1954 to effect a further division in the labor movement by merging the Mine Workers with Mr. Beck's Teamsters and Mr. McDonald's Steelworkers, the way seemed to be cleared, at least as far as personalities were concerned, for immediate merger.

Implications of the Proposed Merger

What are the implications of the proposed merger for labor, for management, and for the public?

The first implication for labor and the public is a much stronger political voice for labor in state and national affairs. The immediate consolidation of the CIO's Political Action Committee and the AFL's League for Political Education will mean that labor will speak with one voice on political affairs rather than two. And this new voice will command more attention from its own members, from legislators, and from the public. It is most unlikely that this unified political strength, however, will be turned in the direction of an independent political party. But this new political strength could easily become the dominant element within the present two-party system.

The proposed merger has several economic implications. For labor the merger means first of all a spirited new organizing effort in the nonunion segments of the economy, with the pooled resources and staffs of the former rival organizations now released for a concerted drive on the unorganized. Considerable success may be expected to crown this effort. The reduction in jurisdictional conflict which the merger will bring will be of inestimable value in this drive to organize the unorganized. It is no secret that labor's failure to make any significant membership gains in the post-World War II period has been of real concern to both the AFL and the CIO. A united labor movement will unquestionably have more success than a divided and competing one in pushing vigorous or-

ganizing campaigns in such areas as chemicals, oil, distribution, textiles, and among white collar workers. And companies with independent unions, as well as other unaffiliated unions such as the Farm Equipment Workers and United Electrical, Radio and Machine Workers, will feel the full weight of this united organizing effort. Thus while a united labor movement cannot expect to match the organizing successes of the late 1930's and early 1940's, its prospects for greater success in this area than it has had in the past ten years appear brighter.

Other economic implications for labor and the public revolve around the prospects for a reduction in the number of unions within the new federation as duplicating jurisdictions and unions are combined, a reduction in corruption and racketeering within the union movement, and an end to racial and other forms of discrimination in union admission policies. The strong statements on these latter points in the merger agreement indicate a firm determination on the part of the new administration to eradicate these evils in the labor movement. Equally strong condemnation of Communist infiltration and influence in the united labor movement is contained in the merger agreement and this re-emphasizes the basic conservative economic philosophy that will be controlling in the new organization.

The implications of a merged labor movement for management are not serious. On the contrary, management may very well have more to gain than to lose from the merger. Management will certainly profit from the reduction

in union jurisdictional fights which all too often have found management injured as an innocent bystander. Furthermore the added strength which a merged labor movement may bring on the organizational and political fronts will not be matched on the economic bargaining front. On this latter front, the merger will have little more than psychological value. Bargaining and negotiation of contracts with management will still be carried on by individual unions — not by the new federation. Economic pressures, including strikes, will still be financed and applied to management by these same individual unions — not by the federation. Management fears of a single, powerful economic bargaining bloc emerging from a united labor movement are, therefore, not justified. And for much the same reasons, expressed public fears of a gigantic labor monopoly developing out of the proposed merger seem unwarranted. Renewed efforts of employers and others to bring trade unions under the restraints of the antitrust laws may be undertaken as a result of the proposed merger, but in the opinion of the writer, the fear that a powerful economic labor monopoly, which could stifle competition and exploit the public, may grow out of a united loose top federation is not well founded. Economic power in the new federation will still be concentrated in the individual affiliated national unions, and this is where it has always been.

If this discussion has given the impression that the continuing issues or

obstacles to complete organic unity of the labor movement are minor or nonexistent, such has not been the intention. On the contrary, the problems yet to be resolved are probably more serious than those already solved. The problem of vested job interests on the part of union officials and staff members in the new merger has not even been tackled as yet. Amicable settlement of this problem alone may require all the labor statesmanship that the new organization can muster. Preserving the integrity of existing unions within the new federation and at the same time attempting to eliminate overlapping jurisdictional claims may prove to be a bigger job than the new organization can handle. The labor personalities involved in the new top federation may find more conflict than agreement in attempting to implement the merger agreement. Will Mr. Beck of the Teamsters, for example, go along with proposals for limiting or reducing his wide jurisdictional claims? And what of John L. Lewis and his future role in the labor movement? Few students of industrial relations would care to count him out, even at 75 years of age, in assessing the future problems and prospects of a united labor movement. But despite all these formidable unsolved problems, the merger movement has gone too far to retreat — it must find some acceptable answers to most of these problems. And many believe a new era for the American Labor Movement may well be under way.

Solutions for the Brazilian Dollar Shortage*

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BRAZIL HAS STRUGGLED with a serious shortage of dollars for several years. The causes and methods of curing this situation are well worth analyzing, not only because the economic and political health of our firmest friend in South America is important to us, but also because many elements in Brazil's economic pattern are typical of other South American countries facing the same problem. To some extent, the same factors underlie the foreign exchange shortages which have led to import and export licensing and which prevent a movement to convertibility in countries in the old world.

Brazil's shortage reached a crisis state last year after coffee failed to move abroad at the government-set minimum price of 87 cents a pound. The increase in the cruzeiro price allowed coffee exporters (from 23.36 to the dollar to 31.50) last August saved the situation by reducing the minimum price to 65 cents per pound (although it remained unchanged in terms of cruzeiros), but the amelioration was temporary. The movement of coffee slowed again early this year. Once more the cruzeiro price allowed coffee exporters was increased (to 36.50 per dollar in February). The effect produced was a reduction in the

minimum price for coffee to 53 cents. Again, coffee exports have picked up. As before, the amelioration is only temporary.¹

A far worse exchange crisis threatens Brazil — a crisis which will arrive when increased supplies of coffee from other areas of the world begin pouring into the international market. This competition will not only reduce Brazil's share of the world coffee market. It will also reduce prices for coffee — a process which has been under way since March of 1954. The consequence will be that foreign exchange earned by coffee, which constitutes 70 percent of all exchange earned by Brazil, will fall to levels considerably below those of recent years. If other Brazilian exports do not increase, the foreign exchange crisis will bring on a transportation crisis — since Brazil depends heavily on trucks which cannot run without imported petroleum — and an industrial and employment crisis — since Brazilian indus-

¹ It is estimated that the carry-over from this year's crop remaining when the new crop begins moving to ports in July will be over 6 million bags compared with a normal 3 million, despite the lower than normal crop of 1954. This will occur despite the fact that spot prices in the New York market last year were 15 to 20 cents above the future market quotation for the new crop. Under these circumstances, a carry-over would usually be reduced to minimum levels. Brazil's financial and price policies have prevented and are preventing movement of coffee in the period when dollar prices are high and will, eventually, result in coffee moving at much lower dollar prices.

* The research on which this paper is based was carried out in Brazil during the author's residence as visiting professor of economics at the Escola de Sociologia e Politica de São Paulo.

try is dependent on imported raw materials and machine parts.

The Causes of the Dollar Shortage

To determine the proper remedies to be used for the prevention of an economic crisis in Brazil, we will first examine the causes of the shortage of foreign exchange. Measures will then be suggested to remove these causes.

First, let us realize that a shortage no longer exists in the sense applicable to the situation prevailing before October, 1953, when Instruction 70 was issued. At that time, there was a demand for dollars, and other currencies, far in excess of the supply available at the prevailing price. The factors which underlay this situation were those which had led to an increase in demand for foreign currencies more rapid than the increase in supply at the fixed exchange rate.

Since Instruction 70, exchange has been sold at auction, and the rise in price has restricted demand. The rise in price to purchasers has not increased the supply, however, since exporters are still being paid low prices for the exchange they earn.

Increasing Demand for Dollars

The demand for foreign currencies expanded after 1940 because of an increasing stock of money. In 1940, the total quantity of money was 11.57 billion cruzeiros. By 1946 the amount of money had doubled and redoubled, reaching 45.76 billion cruzeiros. By 1950, the money supply had almost doubled again to 78.26 billion cruzeiros.² At this writing, there has been a

Table 1. Wholesale Prices

Year	Brazil ^a (1948 = 100)	United States ^b (1947-49 = 100)
1940.....	29	51.1
1946.....	71	78.7
1950.....	127	103.1
1953.....	190	110.1
1954.....	250 ^c	105.5

^a *Conjuntura Econômica*, Marco, 1954, p. 11.

^b *United States Bureau of Labor Statistics*.

^c Eleven-month average, taken from *Conjuntura Econômica*, International Edition, January, 1955, p. 15.

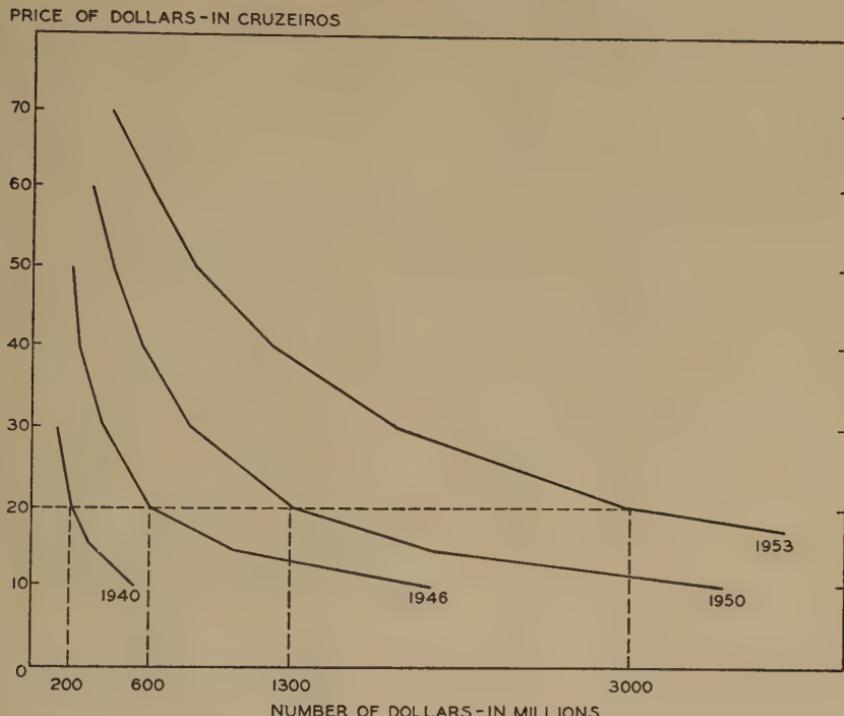
further increase of 90 percent to a level of monetary circulation of more than 148 billion cruzeiros.³ This constant increase in money has led to an expansion in demand for all things, including foreign currencies.

The increasing demand for foreign currencies, at the fixed rate of exchange which prevailed until October, 1953, resulted not only from the increasing supply of means of payment, but also from a rise in Brazilian prices at a rate more rapid than the rise in foreign prices (see Table 1 for a comparison

³ The increase in monetary circulation has occurred in the following ways. Governmental deficits have been financed by printing currency and by borrowing from the banking system. The banking system has been able to increase its demand deposits because of additional reserves provided by the printed currency used to finance deficits and currency printed and made available to banks through the Rediscount Department and Special Bank Loans Department. Because legal restrictions on interest rates have kept them below the equilibrium level, the demand by government, business, agriculture, and real estate promoters for loans has constantly outrun the ability of the banks to meet this demand. See the author's *Causes and Consequences of Inflation in Brazil* (*Estudos de Economia Teorica e Aplicada*, No. 9, Escola de Sociologia e Política de São Paulo, Brazil, 1954).

² International Monetary Fund, *International Financial Statistics*, February, 1955, p. 54.

Hypothetical Brazilian Demand for Dollars



of Brazilian and United States changes in price levels). This meant that an increasing demand for United States dollars was generated not only by rising incomes (or money available for spending) but also by the substitution effect. That is, at any given exchange rate, American goods were becoming relatively cheaper than Brazilian goods. Therefore, Brazilians not only wanted to purchase more foreign goods because of their increased incomes, but also as substitutes for domestic goods.

Although these factors produced a rise in the amount of foreign exchange that Brazilians wanted to purchase *at any given exchange rate*, it does not necessarily follow that there was an increase in the amount of foreign ex-

change purchased. The latter depends on the behavior of exchange rates. Conceivably, the price of foreign currencies could move in a way which would discourage demand. In 1940, if the exchange rate had been 15 cruzeiros to the dollar, Brazilians would have wanted to purchase \$300 million, under the assumed demand conditions shown in the accompanying chart. If the price of the dollar had gone to 50 cruzeiros in 1946, only \$250 million would have been demanded despite the rise of the demand schedule for dollars.

Up to October, 1953, the price of dollars was held at a fixed level despite rising demand. As a consequence, demand began to exceed supply, just as the demand for any good begins to ex-

ceed its supply when its price is held fixed during a period of inflation. Up to 1948, the Brazilian government managed to prevent a serious shortage by supplying dollars which it had accumulated during the war years when goods from foreign sources were not available. Thus, although the amount of exchange wanted exceeded the amount currently earned by exports, the shortage was covered by previously accumulated reserves. When reserves ran dry in 1948, import controls were instituted. These determined who would get the scarce supply of foreign exchange. Not all of those who wished to purchase could be supplied, and import controls were used to maintain rigid exchange rates.

Each year, as the inflation went on while the price of foreign exchange was held fixed, the shortage grew worse because of the rising demand generated by the inflation. The problem of choosing the persons who were to be allowed to buy exchange at the official price became more and more difficult. In these circumstances, the temptations to corruption were enormous, and corruption crept into the agencies administering import and exchange controls.

Since October, 1953, a large part of the exchange earned by Brazil has been sold at auction (or, rather, the right to purchase exchange at the official price has been sold at auction). The effective price of exchange has increased to levels which restrict the amount demanded to equality with the amount available. In the auctions, at least, there is no longer a shortage in the sense that demand exceeds supply.

Waste of Exchange Resulting From Category System

Even though the new system, which began in 1953, has successfully reduced the demand for exchange, it has led to inefficiencies in the use of dollars and wastage of foreign exchange. One of the inefficiencies will illustrate the point. Petroleum is imported at a preferred rate (33.82 cruzeiros to the dollar) while repair parts for trucks and buses are classed in the third category,⁴ for which the rate has gone as high as 150 cruzeiros to the dollar in recent weeks. This has made maintenance and repair of trucks and buses very expensive relative to the cost of gasoline.

In these circumstances, it is not economic to maintain truck engines at peak efficiency since the cost is greater than the value of the gasoline saved. This is one of the factors that leads to an average consumption of 4.3 tons of gasoline per truck per year in Brazil compared with 2.7 tons per truck per year in the United States.⁵ Three dollars worth of gasoline is being wasted in order to avoid spending one dollar on repairs. It does not pay the truck operator to spend one dollar, which

⁴ Five categories of uses have been set up for foreign exchange and exchange is allocated among these, after the demand is satisfied at fixed prices of 18.82 for newsprint, 33.82 for wheat, coal, petroleum, and remittances of dividends and interest and dividends on registered capital, and 36.82 for gasoline and banking remittances. Each allotment of exchange is auctioned for a given category of uses. Prices differ among categories, ranging from 65 to 300 cruzeiros per dollar and change from day to day depending on the bids of the moment.

⁵ Mimeographed report of the Joint Brazil-United States Commission, 1954.

costs more than 150 cruzeiros, to improve engine efficiency in order to save three dollars worth of gasoline. The gasoline costs only 101 cruzeiros because of the preferential exchange rate for dollars spent for petroleum.

Other inefficiencies of this type could be mentioned, such as the use of limestone for cement-making instead of for fertilizer while importing foreign fertilizer at preferred exchange rates, but let us turn to another variety. The presumption that restrictions on the import of luxury goods will make more exchange and capital available for capital formation and industrialization is misleading. The Brazilian who cannot import an automobile may, instead, use his funds for foreign travel. Thus, little exchange saving may result. If he does not use it for foreign travel, he may use it to build a more luxurious home or to purchase domestically produced luxury goods. Resources which might produce goods for export, which would increase the supply of foreign exchange, are used instead for domestically produced luxuries.⁶

Still another effect of the category system is a distortion of the production structure of Brazil in ways which increase the demand for foreign exchange and tend to worsen the shortage of exchange for capital formation. Again, let us illustrate. Because newsprint is imported at the preferential rate of 18.82 cruzeiros to the dollar, newsprint

production in Brazil has fallen. Papermakers find that rising domestic costs, resulting from inflation, make it impossible to compete with the subsidized imports of newsprint. They are ceasing newsprint production and are turning their output into other kinds of paper. With the declining production of domestic newsprint, more and more exchange is being consumed importing this type of paper, and less is left to import machinery and parts.

The Supply of Dollars

The Brazilian exchange situation is approaching a new crisis partly because of expanding demand, but primarily because the supply is shrinking. As inflation has gone on in Brazil, it has caused a rise in costs and increased domestic demand for the products of export industries. These factors have had a detrimental impact on exports. At any given cruzeiro price for export commodities, fewer and fewer goods are offered for shipment abroad.

Fortunately, foreign prices rose more than enough to compensate for this circumstance up to 1951. Up to 1948 the rise was even great enough to induce an expansion of exports for a period with a resultant increase in foreign exchange earnings greater than the rise in foreign prices. Since 1948, foreign prices have not increased sufficiently to raise the cruzeiro return to exporters rapidly enough. As a consequence, the physical volume of Brazilian production for export has been falling since 1948 (with the exception of coffee and cacao). Because of this, foreign exchange earnings did not rise as rapidly as foreign prices from 1948 to 1951. Since 1951, foreign exchange

⁶ For a discussion of the waste of foreign exchange resulting from the banning of luxury imports in favor of capital goods, which are used to equip domestic luxury industries at higher cost, see Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (New York: Oxford University Press, 1953), p. 112.

earnings have been falling because of the continuing decline in physical exports, now at a rate more rapid than the rise in foreign prices. Now that coffee and cacao prices, in dollar terms, are declining, foreign exchange earnings are plummeting downward.

Coffee became Brazil's primary source of exchange because the behavior of its price in foreign markets offset the deleterious effect of domestic inflation, combined with fixed exchange rates, on the volume of production. The price of coffee rose from 5.5 cents a pound in 1939 to 23 cents in 1948. This was a more rapid increase than the rise in the Brazilian price index from 27 to 100. For this reason, production for export was maintained despite the fixed exchange rate and the declining domestic value of the cruzeiro. From 1948 to 1953, coffee prices rose from 23 cents to 58 cents. Again, the rise was greater than the rate of inflation. Brazil's wholesale prices increased by only 91 percent whereas foreign coffee prices rose 151 percent. Coffee production for export was maintained because the foreign price rose more rapidly than costs of production. However, production should have increased in this period, since additional resources devoted to coffee would have brought a much greater social return for Brazil than they produced in other uses. It has not increased because the private return has constantly declined, despite the increasing social return earned by coffee production, as a consequence of the growing underpayment to coffee exporters for the foreign exchange they earn.

In the case of exports other than

Table 2. Physical Volume of Exports^a
(1948 = 100)

Year	Total exports	Cotton	Coffee
1947.....	97	110	84
1948.....	100	100	100
1949.....	90	53	111
1950.....	78	50	85
1951.....	82	55	93
1952.....	66	11	90
1953.....	74	54	89
1954.....	80 ^b	128	51 ^c

^a International Monetary Fund, *International Financial Statistics*, February, 1955, p. 54. The 1954 cotton figure is for eight months.

^b First nine months, *Conjuntura Económica*, International Edition, January, 1955, p. 13.

^c First eleven months, *ibid.*

coffee and cacao, the rise in cruzeiro cost has not been offset by the rise in prices (in foreign currencies) in the export market. The decrease in the value of the cruzeiros received for dollars has, consequently, reduced the incentive to produce for export as long as the cruzeiro return per dollar was held fixed. Once-large exports have declined to minor amounts. This, of course, is the reason that coffee has risen in its importance as a foreign exchange earner from less than 37 percent in 1947 to over 70 percent in 1953. Oranges are exported in less than a quarter of their former volume. Cotton exports, by 1953, shrank to less than half their 1947 volume (although they jumped to record levels in 1954), as shown in Table 2. Textile exports have come to a standstill.

The only thing that has preserved Brazil's foreign exchange earnings since 1948 has been a rise in the foreign price of cacao and coffee. But coffee

and cacao prices are not continuing at their 1954 level. Cacao was high because of the swollen shoot disease in Africa, but it is now 40 percent below its 1954 high. Coffee prices have declined drastically from their 1954 peak as increased production has become available from other areas and as coffee-using habits have changed.

With a fall in prices for the two major Brazilian exports, the supply curve of foreign exchange is shifting negatively even with maintenance of the present physical volume of exports. It is unlikely, however, that the present export volume will continue to be maintained considering the fall in dollar prices. The reduced cruzeiro return will lead to reallocation of resources from export industries to domestic industries, a process which has been under way since 1948.

Remedies for the Dollar Shortage

Obviously, the first step to be taken to stop the worsening of the dollar shortage is to stop inflation in Brazil. Such a step would slow the expansion of demand for dollars and the shrinkage of the supply of exports which earn dollars.⁷

Reduce the Waste of Dollars

The next step, which should be taken at once, would be to eliminate preference rates of exchange given to some

categories of goods such as wheat, newsprint, and petroleum. The resulting increase in cruzeiro prices would lead to more economic use of these items and reduce the demand for foreign exchange to purchase them. Perhaps a reduction in the number of categories for purchase of foreign exchange to only two, with the second category unrestricted as to use, should be the first step taken in the direction of a completely free market with flexible exchange rates for the sale of dollars and other types of exchange.

One of the difficult problems would be to change the registered capital system for allowing exchange for use in paying dividends and interest. In the public utility case, this should be met by revaluation of capital from an original cruzeiro cost basis to a present value basis, as measured by the change in exchange rates, with a change in electricity and other rates to permit the legal rate of return on the new capital base. This would have the advantage not only of eliminating the preferential exchange rate for the import of capital services and the resulting excess demand which gives rise to the shortage now suffered, but would also do much to stimulate the flow of new capital into the utility industries. The new capital would enable the utilities to keep up with the expanding demand for their services instead of lagging behind and bottlenecking industrial expansion. New utility capital would also reduce the demand for privately owned generators which produce electricity inefficiently and waste dollar exchange for petroleum to run these generators. Also, it would improve the supply of

⁷ If exchange rates were flexible and determined in free markets, this would not be necessary to stop the worsening of the dollar crisis. Exchange rate movements would offset the effect of inflation. See the author's "Foreign Exchange" which will appear in a forthcoming issue of *Revista de Ciencias Económicas* (Buenos Aires).

exchange, since dollars would be brought in to pay local costs of installing additional capacity.

Increase the Supply of Dollars

At the same time the number of export categories is reduced, the cruzeiro return allowed exporters should be increased and the number of import categories cut. At present, four categories of payment are used, ranging from 36.50 for coffee dollars to 50.06 for exports in the fourth group (primarily manufactured items). The first three categories, consisting largely of agricultural products, should all be raised to the 43.06 level paid in the third group. This would eliminate the tendency toward uneconomic allocation of fertilizer, machinery, and other factors among different lines of domestic agricultural production.⁸

⁸ In the earlier version of this paper presented last year in Brazil and furnished to the Brazilian finance ministry, a three-category system for purchase of exchange was suggested to replace the then prevailing two-category system. This suggestion was designed to meet the political circumstances then prevailing in Brazil. An immediate shift to a free market would have caused outcries against the resulting higher cruzeiro price of coffee and the greatly increased earnings which would go to producers of coffee, cacao, and cotton. The main purpose of the third category (the first was coffee, the second, other products already exported in appreciable volume) was to provide a much higher rate to those producing exports then moving in negligible quantities. Exports of cotton textiles, meat, ceramics, handbags, leather goods, and other manufactured goods would have been stimulated by this device. Now that coffee and cacao dollar prices are falling, increased exchange rates are less likely to have unwanted political repercussions and discrimination among exporters is less necessary from the political point of view.

Although the top category instituted in January provides a 50.06 rate for each dollar, a considerable improvement over the rate of 28 cruzeiros per dollar which prevailed early last year, the level is inadequate to cure the shortage of exchange. The author has examined cost figures of many Brazilian concerns whose products formerly earned an appreciable portion of Brazil's foreign exchange. On the basis of these data, the conclusion was drawn that a rate of at least 60 cruzeiros to the dollar would be required to make it worth moving a substantial amount of goods into world markets. Since that time, costs have moved even higher.

Not only should the rate for purchase of dollars in the top category be raised. There should also be a system for the other categories (or for the suggested single other category) which would allow the cruzeiro return for each dollar earned to rise as fast as dollar prices fall. In this way, the expectation of a fall in the dollar price of coffee and cacao, for example, would be kept from restricting the willingness of coffee and cacao producers to stay in business and invest the necessary capital required to improve their productivity and maintain Brazil's position in the world's coffee and cacao markets.

Eventually, the category system for both exports and imports should be dropped and foreign exchange should be traded in completely free markets.⁹

⁹ Many Brazilian economists argue against a free market for foreign exchange on the ground that this would mean devaluation and would worsen Brazil's terms of trade. Actually, there is ground to expect that this would improve terms of trade. World dollar prices for Brazil's exports are no longer

The ending of the category system and the present bilateral system of national trading would do much to reduce the cost of doing business abroad and improve Brazil's export volume. It would also stop some of the drain of capital from Brazil occurring because of the fraud practiced under the present system. The exporter who invoices top grade quartz crystals as low grade does not bring the excess dollars, not shown on his invoice, back to Brazil, partly because he might be exposed in trying

influenced to the extent they once were by Brazilian exports. Brazil now supplies less than 40 percent of the world's coffee compared with 75 percent in prewar years. The world demand for Brazilian coffee is, therefore, much more elastic than it once was and is much more elastic than demand for coffee from all sources.

A shift to a free exchange market would have little effect on world dollar prices of Brazil's exports. Brazil would, then, continue to earn nearly as many dollars as it now earns from present exports plus additional dollars from exports which have dried up in the last decade. The increased supply of dollars would cause a drop in the price of foreign exchange in the auction markets compared with what it would otherwise be. This could occur at the same time that the cruzeiro price paid for dollars to exporters goes up since there is now a spread of well over 50 cruzeiros between prices paid for dollars and the prices at which the government sells them at auction.

For an analysis of the improvement in terms of trade of a country resulting from devaluation, see G. Haberler's essay on this subject in *Wirtschaftliche Entwicklung und soziale Ordnung*, edited by E. Lagler and J. Messner (Wien: Verlag Hereld, 1952). Of course, it must be recognized in using the results of Haberler's analysis that devaluation in Brazil would mean that cruzeiro prices paid for exchange to exporters would rise while cruzeiro prices paid for exchange by importers would come down, which makes any movement to a free market in Brazil different from the usual type of devaluation.

to sell a large number of dollars on the market. With free market rates the same as the rate allowed exporters, there would no longer be any incentive to under-invoice and to bribe inspectors to overlook the fraud. This would reduce the incentive to invest dollars abroad instead of in Brazil.¹⁰

If inflation is stopped and a free market for exchange established,¹¹ foreign investors will become more willing to supply capital to Brazil.¹² Without inflation, free market rates will be fairly stable. With no controls on exchange, investors will be more certain of being able to recover their capital if the need arises and will be more certain of being able to remit earnings at nondiscriminatory rates.

Another part of the program for improving Brazil's exchange earnings is the establishment of free trade zones. Many firms in Brazil are interested in processing foreign materials for re-export. They are not being brought in

¹⁰ "It is estimated that there exist Brazilian private accounts of approximately 400 million dollars in the United States, mostly resulting from black marketing." *Brazil Herald*, October 6, 1954, p. 12.

¹¹ For a discussion of the advantages of a free market with flexible exchange rates, see Milton Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953).

¹² The author has had extensive discussions with the treasurers of foreign branches of American companies in Brazil, with officials of Brazilian banks and of American banks with Brazilian branches, and with government officials both in the United States and in Brazil. These discussions have made it evident that the primary barrier to investment was an expected deterioration in free market exchange rates at a rate more rapid than Brazilian prices would rise or earnings could be accumulated on investments.

at present because of tariffs. If the tariffs were not collected or were rebated for materials re-exported from Brazil, new processing industries would be established which would combine Brazilian labor and materials with foreign materials for sale in the world market. For example, imported vitamin products could be added to Brazilian soybeans, which could then be canned, using foreign tin plate. This new product could be supplied to world relief organizations which now buy large quantities of this food in other areas.

Finally, an important step which could be taken to improve foreign demand for Brazilian exports would be to negotiate tariff reductions. Brazil now finds its best market for its major export in the United States. One of the reasons for this lies in the fact that the United States is the only country in the world which does not impose a tariff on Brazil's major export product. The markets in other countries would improve if their tariff, quota, and import-licensing barriers were reduced. Other countries would become more willing to negotiate tariff reductions if Brazilians were allowed the freedom to purchase their products.

Conclusion

In the last few months, steps have been taken by the Brazilian government to slow inflation and to increase incentives to exporters. Restrictions on bank borrowing from the Rediscount Department of the Brazilian central bank and

higher reserve requirements have been instituted. Governmental deficits have been reduced. Measures for controlling inflation, with the announced intent of slowing it to 6 percent a year, are becoming effective. Bonuses to exporters for dollars have been raised, yielding net rates ranging from 36.50 to 50.06 cruzeiros to the dollar. These bonuses are inadequate to cure the shortage of exchange, however. Far more liberal bonuses will have to be allowed to prevent continued deterioration in Brazil's world market position; its share of the world coffee market, for example, has already been reduced from 75 percent to less than 40 percent.

Adjusting for changes in relative purchasing power since 1939, the United States dollar is now worth more than 80 cruzeiros to Brazil. Allowing for changes other than purchasing power which may affect the equilibrium rate of exchange, it appears that the equilibrium rate which would result in a balance between the supply of dollars for cruzeiros and the demand for dollars would be closer to 90 to the dollar (assuming that the Brazilian government continues to monopolize petroleum exploration and allows no foreign investment in this industry). Brazil's exchange crisis will continue to worsen, then, despite the recent changes made in favor of export production. These recent changes will do little more than slow the long-term decline in physical volume of exports which has been going on since 1948.

Labor Market Boundaries—Intercounty Commuting to Employment

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MODERN COMMUTING PRACTICES can be considered from numerous points of view. The development of highway transportation in particular has led to far-reaching changes in the extent to which people travel to markets and in the method of their travel.

The markets for services and for commodities have long been recognized as involving a complex of areal boundaries. The customer of the grocery or drug store is almost invariably local. So is the patron of the shoe repair shop. Contrariwise, the markets for fashion goods, such as clothing and nonservice household equipment and furniture, ordinarily include a much broader area. The market areas for medical service, particularly of a highly specialized type, frequently are larger than retail commodity markets. Consideration of commuting to such market centers is eliminated from this paper.

In the case of commuting to employment, the basic pattern in the vicinity of employment centers which have been closely studied appears to show that employee residences thin out more or less evenly as the distance to the center of employment becomes greater, except where smaller aggregations of population make a difference.¹

¹ Leo F. Schnore, "The Separation of Home and Work: A Problem for Human

A completely systematic examination of commuting patterns, therefore, would necessitate comparison of the dispersion of the commuters' residences with increased distances from employment centers and with other variables without reference to political boundaries. Because the University of Kentucky studies were initiated and largely conducted in order to contribute to finding the distribution of income payments by counties, the data secured incident to these projects relates only to intercounty (including interstate) commuting patterns. For that reason, although the information may be significant for commuting generally, this paper is devoted exclusively to intercounty practices.

All the data which have thus far been assembled² relate to commuting

Ecology," *Social Forces*, XXXII (May, 1954), 336; and Donald L. Foley, "Urban Daytime Population: A Field for Demographic-Ecological Analysis," *Social Forces*, XXXII (May, 1954), 323, and literature there cited.

²This paper is based on figures from employer payroll records for 73,312 employees—a sample approximately stratified (or susceptible of adjustment to a stratified basis) for (a) two-digit industrial classification, (b) plant location within the counties, and (c) plant size. In a few of these cases, the total employment in a labor market center is reported. In addition, 21,056 employees in Cincinnati are reported in such a manner that the sample is distorted by the location

practices in or near Kentucky and strongly indicate that commuting practices differ considerably from place to place. It will be apparent, therefore, that the conclusions based on Kentucky studies³ are in the nature of hypotheses as to the characteristics of general commuting to employment. At the same time, as will be indicated later, some of the findings are much more persuasive than others. It might, therefore, be said, not altogether facetiously, that some of the evidence merely suggests a hypothesis; some justifies a full-fledged hypothesis; and some provides a basis for a theory.

Thus, this paper is narrowly limited in scope. It excludes consideration of commuting to commodity and service market centers. It omits aspects of commuting to employment other than those which are intercounty in character. It

of the reporting plants. Also, the authors have examined data for additional workers reported in response to comprehensive mail questionnaires sent employers. These last statistics are of little value except to demonstrate that mail inquiry is a decidedly unsatisfactory tool for this kind of study.

The field work on which this paper is based has extended over a considerable period, but most of it occurred early in 1952 and late in 1954. For present purposes the statistics are regarded as being current.

³ Although additional inquiries have been conducted in Kentucky, the core investigations have involved full-fledged examination of data assembled from employers' records in these areas: Paducah, Louisville, the Cincinnati suburbs in northern Kentucky, and Lexington—the first three reported respectively in Frank G. Coolsen, Will S. Myers, and James W. Martin, *Paducah and Western Kentucky Income, Labor and Retail Trade Patterns* (Frankfort: Agricultural and Industrial Development Board of Kentucky, 1952); James W. Martin and Will S. Myers, *Aspects of the Louisville Area Economy* (Frankfort: Agricultural and Industrial Development Board of Kentucky,

rests on data which are sufficiently limited in coverage that the showings are to be regarded simply as the basis for the formulation of general hypotheses with respect to commuting to centers of employment. Subject to these limitations, the following sections consider the most important characteristics of employee commuting.

I.

The extent and character of commuting depends in large measure on historical factors in a particular community. First of all, there is a general trend toward more and more commuting as transportation facilities are improved. This trend is secular and occurs along with other variations noted in this discussion. As a consequence of this trend, the nature of labor mobility is changing. For example, two workers who live next door to each other in a small town may compete for

1953); and John L. Johnson, *The Economy of Northern Kentucky* (Frankfort: Agricultural and Industrial Development Board of Kentucky, 1954). Other areas, not separately reported, include three military installations and state employment at the capital. The first three studies concern commuting to employment generally but with varying emphasis. The Lexington study has not yet been published. In addition, other less thorough investigations have been made and results utilized in making estimates of income payments by counties in John L. Johnson, *Income in Kentucky: County Distributions by Amount, by Type, and by Size* (Lexington: University of Kentucky Press, 1955). These include for the state generally employment at military installations, at construction projects involving public or educational building of a major character, and a cursory survey of commuting practices at all important employment centers near the boundaries of Kentucky. They also include scattered additional information too incomplete to be more than suggestive.

jobs within an area included in a radius of 20 miles or more. They may commute to jobs many miles away from their homes and in opposite directions. Thus, employers as much as 40 to 60 miles apart may compete for the labor of the two men. A few years ago an employer 20 miles from a village could attract employees from that village in most instances only if the employee moved to the place where the plant was located. The change that has occurred means, in effect, that there is a new type of labor mobility. The employer now has access to laborers in distant areas through the medium of commuting—a kind of mobility that formerly was relatively unknown. Commuting, particularly in communities experiencing rapid economic growth, brings about a totally different situation with respect to labor market boundaries.

A second historical aspect is the rate at which economic growth is occurring. For example, if the growth of manufacturing is extremely rapid in a particular center of employment, and especially if the scale of the activity is substantial, an increase in commuting occurs with the increase in manufacturing but at a much more rapid rate. As the rate of manufacturing growth declines, commuting is reduced.

Transportation conditions generally affect commuting, at least commuting by automobile,⁴ but the evidence that this is the case is largely confined to particular, fairly clear-cut, and local-

ized situations. In the vicinity of Cincinnati and, therefore, of the Kentucky cities of Covington and Newport, the outstanding example of this has to do mainly with the use of bridges across the Ohio River, the location of such bridges, and the control of intercity traffic. In many instances where street and highway facilities have been adjusted to current or estimated future needs, the increases in traffic loads have surpassed expectations, especially where there is a free bridge and the traffic pattern is such that the interstate movement of vehicles is facilitated. Apparently many persons who had not been using the existing transportation facilities were awaiting improvements. Moreover, the action is cumulative. A large number of commuters may inspire public agencies to make commuting easier, but when this is done more persons are encouraged to commute. The situation in commuting is very much the same as that in city automotive traffic generally, and particularly in traffic in suburban areas.

Although one of the few early surveys of intercounty commuting⁵ concluded that the amount of travel to work from outside the county depended on the size of the city, the Kentucky study tends strongly to demonstrate that there is no such relationship in the Blue

⁴ The Kentucky studies have not as yet undertaken to distinguish commuting by common carrier from commuting by private automobile or, in the latter instance, to find out average commuter loads.

⁵ "Survey of Indiana Commuting Patterns," *The Labor Market and Employment Security*, July, 1950, pp. 11-13. In the light of findings by J. Douglas Carroll, Jr., *Home-Work Relationships of Industrial Employees: An Investigation of Living and Working Places for Industrial Employees with Attention to Implications for Industrial Siting and City Planning* (unpublished doctoral dissertation, Harvard University, 1950), relied on by Foley, *loc. cit.*, it may well be

Grass area.⁶ On the contrary, it is clear that large-scale opportunity for employment, especially if developments are rapid and occur in manufacturing or related areas, stimulates commuting in the area, even if there is no city at all. For example, commuting is distinctly high to state employment at the small-town capital. It is also high in the case of certain military installations in completely rural areas where civilian employment is substantial.

II.

The extent and probably the nature of commuting varies with the characteristics of the employment offered at labor market centers. There are numerous types of variation which affect the labor market area; and those which have been established, even provisionally, will be outlined at length.

First of all, the extent of commuting is dependent on the character of employment in the sense that commuting is much greater in manufacturing and heavy construction than in other types of employment. The available evidence suggests that heavy construction which involves a large number of workers assembled quickly at a given plant brings about more commuting than any other type of activity. The evidence on this point, although fairly definite in a number of situations, is particularly impressive in the case of the Atomic Energy Commission plant and the two power plants which have been con-

structed in the vicinity of Paducah since late 1950. Somewhat the same situation existed in the area of Calvert City just east of Paducah. But there was no such clear-cut evidence when General Electric began the development of its large plant in Louisville, possibly because the city itself is a large labor market and at that time contained some unemployed construction workers.

In the case of manufacturing, the data assembled from every part of the state tend to indicate that commuting to manufacturing employment is much more extensive than commuting to employment in service, trade, or finance, and is greater, in fact, than commuting to employment in construction, except in major heavy construction. For example, at Louisville manufacturing intercounty commuting is more than 13 percent of all employment, whereas nonmanufacturing commuting is less than 5.5 percent. At Paducah, ignoring the heavy construction, the respective percentages are 18.2 and 5.1.

From the evidence available there is reason to believe that some differences in commuting patterns stem from variations in the stability of employment. In certain instances it has been possible to establish that, within manufacturing, some employers who have unstable job records or those in a seasonal industry, have much more commuting than do manufacturers in the same community who have relative employment stability. For example, in the Lexington area intercounty commuters account for 15.7 percent of all manufacturing employment. If, however, the tobacco-processing plants, which have the least stable employment in the labor market, are excluded, the proportion drops to 10.0

that in very large cities with highly developed mass transportation, there are definite variations in intercounty commuting according to size of city.

⁶ As would be expected, the Kentucky statistics are most adequate on sheer volume by employment centers.

percent. This striking evidence is no different in basic principle from that which is found in various other areas where careful studies have been made.

Although the point may have little significance, the data which have been assembled thus far appear to indicate that although commuting is far short of what it is in manufacturing, mining and service have more than trade and finance. Whether this fact, if indeed it proves to be a fact, is significant of relative stability in employment has not yet been established.

The most clear-cut showing of all, if the Kentucky data are typical, is the variation in commuting with the size of the employer. The entire body of evidence from every section of the state and from border centers outside the state tends to show that larger plants, measured by the number of employees, have more commuting on the whole than do smaller plants. Moreover, although this is the basic pattern in all types of business enterprise, it is of interest that the differences are more marked in manufacturing than in other activities. For example, in the Paducah area plants of all classes except heavy construction which have 100 to 499 workers, 16 percent of the workers resided in counties other than McCracken, the county in which Paducah is situated. In plants having fewer than 50 workers, intercounty commuters made up only a little more than 5 percent of the work force. By way of contrast, all manufacturing plants in the same community in which total employment was between 100 and 499 employed 24.3 percent of their workers from counties other than McCracken;

and plants having fewer than 50 workers employed only 1 percent. This situation, although perhaps a little clearer in the Paducah situation than in the other areas studied, is systematically exhibited in every other instance in which a reasonable sample of data has been gathered and analyzed. Data on commuting which have been collected and classified by plant size show the following ratio of commuters to the total number of laborers:

500 employees or more	22.8 percent
100 to 499 employees	14.1 percent
Fewer than 100 employees	11.0 percent

Total 18.8 percent

One might suppose that commuting would also vary with the level of wages paid by different employers. The evidence which has been assembled in each of the four important labor markets surveyed tends to sustain the proposition that there is little, if any, variation in commuting resulting from differences in wage levels. Using the Lexington market center as an illustration, it appears, first, that there is as much commuting in the low-monthly-wage industries as in the high-wage industries, and perhaps more. Second, there is little, if any, difference in the average wage of nonsupervisory commuters and of all nonsupervisory employees in any of the individual plants in the sample. When a difference in the average wage level does exist, it is more often than not a lower-than-average wage for the commuters. It is understandable that wage levels make for little difference in commuting patterns if the choice the individual commuter has to make is, not between Fayette

County or Lexington wage rates and local wage rates, but between Fayette County wage rates and none at all. This appears to be fairly typical, especially among female commuters.⁷

Among the counties in the Fayette County market area, there is considerable variation in the average monthly wage in covered employment. The range in 1953 was from an average of \$163 a month in the lowest-wage county in the area to an average of \$264 a month in Fayette County.⁸ It is apparent from the data collected thus far that men and women who reside in another county and commute to their work in Fayette County, or for that matter to any other industrialized county in the state, earn more than they could in their home counties, taking account of the actual cost of commuting and the value of their time

in getting to and from work. Wage levels, then, may be a factor; but they can influence commuting only if the average wage in the employment center for a single type of labor is higher than in the other counties in the area. There is no evidence that the high-wage industries on the whole attract more commuters than do the low-wage industries or the reverse.

There are several issues having to do with the general characteristics of employers which affect the extent and probably the nature of commuting. Since the problem has been examined more particularly in the case of manufacturing, certain observations will be outlined with respect to that class of industry. By far the most important element in the situation, taking the various markets into account, appears to be the stability of employment. The seasonal manufacturer, for example, has considerably more commuting than does the manufacturer with substantially the same employment level throughout the year. This is particularly marked in the Lexington area where tobacco processing, the most highly seasonal of the important manufacturing activities in the community, employs a far larger proportion of commuters than do any of the other lines of manufacturing business. This appears to be explained largely by the stability situation. The level of intercounty commuting in the tobacco-processing business is more than 33 percent of all employees whereas the general average of all manufacturing, as previously noted, is 15.7 percent and with

⁷ The evidence suggests that intercounty commuting, which makes employment opportunities more generally available, attracts many individuals not previously in the work force. This appears to be especially true of women. That such opportunity results in a net enlargement of the work force in the farm and nonfarm rural population of one section is circumstantially supported also by Robert E. Galloway, *Employment of Members of Rural Families in the Purchase Area of Western Kentucky* (Kentucky Agricultural Experiment Station in cooperation with Agricultural Marketing Service, United States Department of Agriculture, manuscript, not yet published).

⁸ Computed from unpublished data on total income and average employment, Kentucky Department of Economic Security, Frankfort, Kentucky. Most of this difference stems from the difference in the prevailing types of industry, not so much from wage differences in the same industry. (Wage levels are computed by dividing wage payments by the number employed.)

the seasonal industries excluded only 10.0 percent. Thus, it may be concluded that highly seasonal manufacturing may involve approximately two or three times as large a proportion of commuters as does nonseasonal activity in the same community.

Another reason for variations in the extent of commuting and possibly also in the characteristics of the commuter has to do with the degree to which employers favor a commuter as compared with a local employee. In one area employers were explicitly queried about this point and their responses were varied. The majority had no settled rule, but most of those with a definite policy expressed a preference that their employees reside in the county. This preference was usually based on a fear that an increased number of commuters would enlarge the degree of labor turnover, absenteeism, tardiness, or all three. Some employers appeared to have no concern over where their employees lived; but a few, mostly among the larger firms, indicated that company policy accords preference to non-residents on the ground that they are more reliable than persons who can be hired locally. Particular inquiry in one labor market and general observation in others support the proposition that the most important labor market boundaries are geographical; that there are many labor markets⁹ within the general boundaries of the labor market area; and that labor is a heterogeneous serv-

ice, each type with its own market area. Unquestionably, the extent to which employers favor commuting has a decided bearing on the size of the labor market.

A kindred issue is whether or not the fact that plants enter into collective bargaining agreements (or, lacking these, observe a systematic seniority plan) has any effect on commuting. Although the Kentucky data on this point are limited, they justify the hypothesis that such conditions have no significant influence on the proportion of persons from outside the county who commute to manufacturing employment.

A final variable among manufacturers which appears to influence intercounty commuting is the product made. Available information indicates that intercounty commuting to employment is exceptionally high in tobacco manufacturing and in production of machinery, metal products, and equipment. It is also high in paper, printing, and publishing; but this showing is heavily influenced by large concerns near the state line at Cincinnati and Louisville; otherwise employee commuting appears to be moderate in these industries. The amount of intercounty commuting is likewise moderate (12 to 15 percent) in food and related products; textiles, clothing, and leather; lumber and furniture; chemicals, petroleum, coal, and rubber; and stone, clay, and glass production. It is decidedly low in automotive and miscellaneous manufacturing.

⁹ Lloyd G. Reynolds, in *The Structure of Labor Markets* (New York: Harper and Brothers, 1950), speaks of a labor market as "a honeycomb of submarkets."

III.

Not only does commuting vary among different situations depending on historical background and on the type of employment, but variations may also be dependent on the characteristics of the worker. This issue has been raised in what has already been said but will be expressly outlined in terms of worker characteristics so far as the study up to this point makes such an outline possible.

There is often a supposition that the extent of commuting must vary with the sex of the employee. The studies which have been made in Kentucky tend strongly to discredit this assumption. As a matter of fact, the relation of male and of female commuting to total employment in various types of plants tends to support the proposition that there is practically no difference—depending on sex in the percentage of total employment represented by commuters. There is some variation in a few instances.

The same observation does not apply with respect to the skill of workers. Here the market area for employees of different kinds of plants and for different classes of workers within each kind depends on the skills available. The market area for one type of skill may be such as to involve considerable commuting to a given plant, and the market area for another type of skill may be such as to necessitate little or no commuting.¹⁰ The extent to which

these variables operate in a particular labor market appears to depend fairly definitely on the characteristics of the market and on the characteristics of the employment available. It is of particular interest that low-wage workers seem to commute as much as, or perhaps more than, the higher-wage employees in the two markets where the problem has been most extensively studied. This is seemingly merely because the unskilled laborers actually live in widely scattered areas whereas skilled laborers for the particular employment at hand seem to live mostly at employment centers.

Summary

Study of intercounty commuting to employment in Kentucky and nearby labor market centers justifies the following conclusions—some of them provisional—concerning current local experience. These generalizations may suggest hypotheses for a general theory of commuting.

(1) Commuting is greater (a) with rapid, large-scale growth in employment opportunities; (b) with the secular trend toward increased use of highway transportation; and (c) with better road facilities which decrease the cost of transportation or decrease the time required to reach the place of employment. It does not, however, vary significantly with the size of the city in which the employment center is located.

(2) The proportion of total employees who commute is greater (a) in heavy construction and manufacturing than in other types of business; (b) in seasonal than in stable employment.

¹⁰ Findings in earlier mobility studies would lead one to expect this finding. See, for example, Natalie Ragoff, *Recent Trends in Occupational Mobility* (Glencoe, Ill.: Free Press, 1953), especially pocket tables.

(c) in plants having a large work force than in those having a small number of employees; and (d) in manufacturing. The number of commuters relative to the total number of workers is also affected by employer hiring policy. However, it appears that commuting does not vary significantly with union-

ization or with seniority arrangements, or with the monthly average wage paid by the employer.

(3) The proportion of employees who commute to work depends heavily on the skill of the workers, but does not appear to depend on the sex of the employee.

Is the Housing Boom Dangerous?

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THE TOLL of the 1930 depression was large in terms of dollar losses but there may have been an even greater levy against the capacity of people to view prosperity without suspicion. The great optimism of the 1920's that prefaced the dismal depression has placed economic optimism in ill repute. Certainly, caution is a quality worth exhibiting in business forecasting, but there is an important distinction between caution and a firm conviction that all is for the worst. It is appropriate to examine the reasons for the substantial volume of housebuilding since the end of World War II and to determine, if possible, whether the sources of the boom are exhausted. One cannot assume that since there has been a great deal of building activity there must be a corresponding period of inactivity. There are forces and factors in the economy which indicate that housebuilding may be expected to continue at a high level; furthermore, it is entirely possible that the "boom" in housing has passed and that the present rate of building is more normal than abnormal.

Among the reasons advanced for fearing that housebuilding is a danger spot in the economy are: (1) the high volume of mortgage debt outstanding; (2) the historical building cycle and the very size of current capital outlays for housing; and (3) the decline in the rate of family formation.

It is possible that expenditures for housing in the past ten years may in

one way or another lead to or aid in the development of economic difficulties but the sentiment of this article is contrary to such a point of view. The least forceful position taken here is that the reasons advanced in the previous paragraph are insufficient to warrant our being fearful of the housing investment sector of the economy.

I.

Home mortgage debt reached \$75 billion at the end of 1954. Compared with only \$18½ billion outstanding at the end of 1945, the 1954 figure marks a spectacular growth. The increase is not so astonishing, however, if one considers the shortage of housing existing at the end of World War II because of the relatively small amount of building between 1930 and 1945 compared with the growth of population and number of families during the same period. Population increased about 17 million during those years and marriages averaged almost 1.5 million each year, although new households were formed at a rate of only 500,000 each year.¹ Marriages substantially exceeded independent family formation in these years. In the period 1930-49 dwelling starts matched household formation only in 1941, and most of the time the number of housing starts was considerably lower than that of household for-

¹ Gilbert Burck and Sanford Parker, "The Changing American Market," *Fortune*, August, 1953, p. 99.

mations.² A large share of the building between 1945 and 1950 can be attributed to the disparity between independent family growth and housebuilding from 1930 to 1945. The postwar increase in mortgage indebtedness is understandable under these conditions.

Part of the large change in mortgage debt is explained by building cost increases. Building costs tripled from 1930 to 1955; there was approximately a 72-percent increase from 1946 to 1955.³ Cost increases of such magnitude obviously push dollar totals of mortgage debt upward.

Other factors giving rise to increases in mortgage debt were the shift from tenant occupancy toward owner occupancy and the mobility of families in the extensive postwar urban decentralization. Home ownership went from 43.6 percent of occupied dwelling units in 1940 to 55 percent in 1950. A current estimate suggests that probably 60 percent of the nation's dwelling units are now owner-occupied.⁴ Population shifts accompanying new plant locations and new industrial developments and the attraction of residential suburbs reinforced the residential building boom.⁵

These reasons for the rise in mortgage debt are actually the "effects" of more fundamental "causes." The basic

² First National City Bank of New York, "A Boom That Defies Predictions," in the Bank's *Monthly Letter, Business and Economic Conditions*, April, 1955, p. 45.

³ Calculated from the American Appraisal Company Construction Cost Indexes reported in their *Clients Service Bulletin*, February, 1955.

⁴ Cleveland Trust Company, *Business Bulletin*, March 16, 1955, p. 2.

⁵ See Burck and Parker, *loc. cit.*, pp. 103 ff. for a good discussion of these trends.

reasons for the heavy volume of building and therefore the growth of mortgage debt are the prosperity of the postwar years and the relatively easy terms on which mortgage credit has been available. The question at hand is whether these permitted mortgage debt to rise to unwarranted heights.

One way of measuring the burden of mortgage debt is to compare it with total disposable personal income. The *Business Bulletin* of the Cleveland Trust Company compared the ratio of home mortgage debt to disposable personal income for the years 1929-54 and found the ratio for the end of 1954 to be 29.6 percent, the same as for the end of 1934.⁶ It found also that the ratio has been rising since 1945. "But it is questionable as to how significant this may be, partly because of the trend from rentals to home ownership."⁷ The sharp shift from tenant occupancy to owner occupancy brought an increase in debt but practically no change in monthly expenditures for living space since mortgage payments were substituted for rent.⁸

Lower interest rates and longer maturities of recent years have actually made mortgage debt less of a national burden, relatively, than in prewar years. George C. Johnson, president of the Dime Savings Bank of Brooklyn is quoted in the April *Letter* of the First National City Bank: "Regular payments on mortgage principal and interest now amount to about 2.6 per

⁶ *Business Bulletin, op. cit.*

⁷ *Ibid.*

⁸ It is conceivable that the shortage of rental units after the war drove rental prices (including extra-legal payments) to higher levels than mortgage payments on similar accommodations.

cent of all spendable income, compared with 2.7 per cent in 1939—a year in which mortgage debt was not considered excessive.”¹⁰ A Federal Reserve survey found early in 1954 that 75 percent of home owners with mortgages spent less than 20 percent of their income on mortgage interest, principal repayments, and property taxes; only 8 percent spent more than 30 percent of their incomes for these purposes.¹¹ These figures are not surprising since most lenders and the FHA and the VA generally adhere to the established rule of thumb that such charges should not exceed 25 percent of a borrower’s disposable income. The mortgage lenders, while they may express concern from time to time about growing indebtedness, have individually done a good job of relating borrowers’ obligations to ability to repay and have helped make it possible to conclude that mortgage debt is not “too high.”¹²

II.

Another important reason for fearing the present rate of housebuilding is the historical 18-20 year building cycle. There is evidence that the well-defined

¹⁰ *Business and Economic Conditions, op. cit.*

¹¹ *Ibid.*, p. 47.

¹² The growing fear of the size of the mortgage debt stimulated a number of writers to consider the question. It is interesting to note that the March 16, 1955, issue of the Cleveland Trust Company *Business Bulletin* and the April issues of the First National City Bank *Letter* and the *Monthly Business Review* of the Federal Reserve Bank of Cleveland, all of which were published at about the same time, carried articles attacking the premise that mortgage debt is too high. All three articles were similarly organized and reasoned.

cycles of past years outlined by Long and Riggelman were to a large extent the products of inadequate statistical data.¹³ Additional data available since the Long and Riggelman studies permitted Miles Colean and Robinson Newcomb to conclude: “The supposed regularity of major construction cycles over a long period of time thus does not appear to be proved.”¹⁴ The distortions in the rate of building which have occurred in past years have been caused chiefly by wars and not by inherent characteristics in the demand for building or the construction industry.¹⁵ The importance of the Colean and Newcomb findings is their opposition to the concept that a decline in building is inevitable because of something in the nature of building activity.

A major difficulty of developing sound evidence to describe the behavior of the construction market has been to find appropriate measuring devices. Even though the housebuilding boom of recent years has been the largest in history from the standpoint of number of units started, alternate methods of measurement indicate that the post-World War II boom has been less in-

¹³ Clarence D. Long, Jr., *Building Cycles and the Theory of Investment* (Princeton: Princeton University Press, 1940); John R. Riggelman, *Variations in Building Activity in United States Cities* (unpublished thesis, Johns Hopkins University, 1934), and “Building Cycles in the United States, 1875-1932,” *Journal of the American Statistical Association*, XXVIII (1933), 174-83.

¹⁴ Miles L. Colean and Robinson Newcomb, *Stabilizing Construction: The Record and Potential* (New York: McGraw-Hill Book Company, 1952), p. 57. See Appendix N of Colean and Newcomb for a detailed account of their refutation of the Long and Riggelman series.

¹⁵ *Ibid.*

tense than previous ones.¹⁵ Winnick's calculations reveal a lower level of housebuilding in relation to total national production in the current boom than in either the 1920's or the 1890's. Residential construction outlays (excluding repairs and maintenance) measured as a proportion of either total national production or capital formation have declined since 1890 and *per capita real value* of the units in the housing stock failed to show any marked trend during the first fifty years of this century while the *average real value* per dwelling unit fell.¹⁶ Since Winnick's efforts show this boom to be relatively less intense than previous ones, the least that can be argued is that current capital outlays for housing are less of a potential disturbing economic factor than they have been in past boom periods.

III.

A case against worrying about the current disparity between the rates of independent household formation and housing starts cannot be conclusive because the principal arguments are based on relatively recent and untested changes in the economy. Household formation¹⁷ is only one of the factors creating the demand for new housing. In the absence of new household formation, houses will be built to take care of destroyed dwellings, changes in

¹⁵ Louis Winnick, "Housing: Has There Been a Downward Shift in Consumers Preferences?" *Quarterly Journal of Economics*, LXIX, (February, 1955), 85-98.

¹⁶ *Ibid.*, pp. 85-86.

¹⁷ A household is one or more persons occupying a house, apartment, or other group of rooms which is within itself a dwelling unit.

family tastes which require "better" housing, population shifts, and changes in family size. It is unlikely that household formation ever will be negligible, however, for the very forces which govern residential changes by existing households are also important in prompting the development of new households. These factors are: (1) real incomes, (2) mortgage financing terms, and (3) real estate prices as compared with prices of other commodities and services.

Substantial changes in income distribution, real estate financing terms, family sizes, urban decentralization, and building technology have changed the character of the demand for new housing. These same things are expected to operate to increase the rate of household formation and bring it closer to the rate of new building even in advance of the new families which may be expected when the World War II baby crop reaches marriageable age in the early 1960's. Each of these factors and their influence on housing demand and new household formation is examined in the following paragraphs.

Housing as it is known in this country is in a sense a luxury commodity. As in the case of such commodities, its demand is affected by changes in real income.¹⁸ A rise in real incomes increases the total number of families seeking to occupy separate residences. Increased household formation occurs in the form of undoubling, an increase

¹⁸ Estimates of the income elasticity of demand for residential real estate may be found in Ernest M. Fisher, *Urban Real Estate Markets; Characteristics and Financing* (New York: National Bureau of Economic Research, 1951).

in the marriage rate, and single persons setting up independent quarters. Even if the total number of households remained constant, a rise in real income would be reflected in additional expenditures to improve housing standards.

The income-family formation-housing demand relationship is important to the argument of this paper because of the historical growth of real income and shifts in the income structure. The latter is particularly significant because there has been a reduction in the number of very low incomes (and very high incomes) and a growth of a larger "middle income" group capable of forming independent households and therefore of stimulating housing demand.¹⁹ Downward shifts in "high" incomes may eliminate castle building but will not remove the group receiving the reduced "high" incomes from the housing market.

Next to personal incomes, the most important demand factor in the real estate markets is the terms on which mortgage money is available. The terms on which mortgage lenders are able to loan have been relaxed by permitting lower down payments and longer maturities, thereby reducing monthly debt service charges.²⁰ Reductions in equity

¹⁹ See *Fortune*, "The Rich Middle-Income Class," May, 1954, pp. 94-98 ff. For a different point of view see Robert J. Lampman, "Recent Changes in Income Inequality Reconsidered," *American Economic Review*, XLIV (June, 1954), pp. 251-68.

²⁰ Although popular notions of the amount of "shoe-string" financing of residential real estate are probably exaggerated, the ratio of equity to debt in mortgage transactions has been declining for at least 30 years. For a scholarly treatment of this subject see Leo Grebler, "The Flow of Funds into New Residential Construction, 1911-1952," *Journal of Finance*, December, 1954, pp. 339-50.

requirements and monthly payments have an effect similar to real income increases. A combination of real income and financing adjustments provide a strong boost to the demand for real estate.

Innovations in mortgage financing in the form of open-end and package mortgages may be expected to further stimulate the demand for residential units. The open-end mortgage provides for additional advances to be made by the mortgagor on the security of the lien created at the time the original note was made. Additional advances are frequently restricted to home improvements and are a relatively painless way of financing them. The open-end mortgage may help to sustain the values of older homes by making it comparatively easy to acquire an old house and modernize it, for the additional advances may be repaid over the unexpired term of the original loan. The possibility of amortizing a debt over fifteen or twenty years instead of two or three will increase the number of people who can and will borrow to revitalize old houses and the number who will undertake home ownership with the idea of improving an older unit.

The package mortgage permits items ordinarily classified as chattels, such as stoves, refrigerators, washers, and dryers, to be included as real estate and therefore financed on a long-term real estate mortgage. One of the explanations advanced by Winnick for the failure of housebuilding to grow relative to the rest of the economy and to previous booms was the competition between housing and consumer dur-

bles.²¹ If the competition could be partially eliminated by converting appliances to real estate, a potential home buyer could buy both the real estate and the household goods almost as easily as he could acquire appliances alone through installment credit.

Both open-end and package mortgages are being received with favor by mortgage lenders. It is expected that these financing variations alone may stimulate independent household formation and housing demand.

Population factors have played important roles in the boom and may be expected to account for additional new houses. Population shifts accompanying industrial and commercial decentralization and growth have been an important source of housing demand.²²

Changes in the size of families have added to the market for new housing. Increases in the number of children per family have brought a need for larger quarters. The one- and two-bedroom homes built immediately after World War II for young married couples are no longer satisfactory for a growing number of parents having their third and fourth children. The trend toward more children per family combined with the growth of one- and two-person households (widows, newlyweds, unmarried adults) creates a strong basis for increased housing demand.

The relative cost of housing is an important element in housing demand because the residential units and their services offered in the market typically

are of better quality than would be required to provide only basic shelter. For the first fifty years of this century consumer preferences shifted away from housing to things such as automobiles and household durables which were experiencing pronounced improvements and reductions in real cost. Meanwhile, housing almost managed to avoid industrial and technological change. But the extreme pressure for housing at the end of World War II broke down much of the resistance to innovation in building and real improvements in housing have been coming along rapidly, particularly since 1950. The competitive position of real estate as a consumer product has, consequently, been improved and there has developed a higher consumer preference for housing.

Much of the boom since 1950 can be traced to the increased attractiveness of housing. Real estate's improved competitive position is reflected in the preliminary reports of the 1955 Survey of Consumer Finances of the Survey Research Center, University of Michigan. Consumer demand for housing is reportedly stronger than for any other type of consumer durable good.²³

It would be surprising if the apparent shift in consumer preference for housing is not further stimulated by additional real improvements in the product. One of the principal competitors for the housing dollar is the automobile. Simply because automobile manufacturers have already made considerable progress in product design and performance, the job of continued

²¹ Winnick. *loc. cit.*, p. 90.

²² See Dorothy K. Newman, "Decentralization of Industrial and Commercial Building," *Illinois Business Review*, January, 1955, pp. 8-9, for a discussion of commercial and industrial building activity.

²³ "Preliminary Findings of the 1955 Survey of Consumer Finances," *Federal Reserve Bulletin*, March, 1955, pp. 249-51.

improvement is relatively more difficult than it is for house designers and builders who have only recently begun to make effective changes in houses. Housebuilders have yet to create for themselves much of a replacement market, a common thing in automobiles and other consumer durables, but continued innovation can be expected to create some replacement demand even for houses.

A conversion of the housing market in the direction of the characteristics of the automobile market would obviously require older houses to fall in value more rapidly than they have in the past. At first look, this has contradictory influences. Reduced values of older houses should stimulate increased independent household formation because demand for housing is not only income elastic but also price elastic. But if prices of second-hand houses fall, will their owners be able to afford to sell them in order to take advantage of new houses? Changes in the terms of mortgage financing described earlier probably will resolve this difficulty. Car owners are not prevented from buying new ones because their old ones have declined in value, largely because of the basis on which automobiles are financed. Furthermore, the decline in old-house prices will be partially mitigated or prevented by growing ease of financing old houses as well as new ones. A smaller fall in price is needed to induce a sale if relatively easy mortgage terms are available. The combined elasticities of income, price, and financing terms ought to expedite the filtering of old houses through the market.

One of the factors which permits optimism about the housing market strength is the lack of vacancies in most cities. The annual vacancy survey of the National Association of Real Estate Boards, which includes reports from 274 real estate boards in 44 states, reveals that vacancies are at a very low level. Seventy-eight percent of the cities studied reported vacancy levels of 2 percent or less, practically the same as in the previous year.²⁴ The historically accepted "normal" vacancy rate is 5 percent, but only 6 percent of the communities reported vacancies of more than 5 percent. The vacancies reported were concentrated in older houses converted to apartments and in multi-family structures. Rental declines reported occurred mostly in walk-up apartments in larger cities and in converted units in older dwellings.²⁵

The very absence of vacancies suggests either that the disparity between new housing starts and household formation is overstated or that the vacancy figures or household estimates are wrong. Both estimates are probably subject to considerable error; however, there is no evidence that vacancies have risen sharply or are even close to historically customary levels. The very definition of "household" requires that there be vacancies if dwelling units exceed households and while this may be the case in a few communities or in certain types of dwellings it obviously is not a general and widespread condition. Accurate statistics on the num-

²⁴ "Residential Vacancy Rates," *Headlines*, February 21, 1955.

²⁵ This undoubtedly reflects continued demand for higher-quality housing.

ber of dwellings removed from the housing stock each year are not available, but estimates range from 50,000 to 200,000 with the figure growing rapidly each year because of the increased interest in urban renewal and slum clearance. In the face of the absence of substantial vacancies, this disparity between net changes in the housing stock and new family formation cannot be very great.

One interesting facet of this question of dwelling starts and household formation is that if there is no increase in the housing stock relative to households the poor-quality housing in the country cannot be dropped out. The fundamental answer to slum clearance is to build more units than are currently needed for new families so that established families can subdivide themselves or at least get better quarters. This is a process known as filtering, in which old dwellings fall in value as the result of the introduction of new units. Presumably, lower-income families acquire better housing for the same money. Filtering has not been sufficient to eliminate slums in this country but it has worked to raise the average level of housing. Conditions have never existed which have channeled enough investment into housing to allow filtering to affect the bottom strata of the housing stock. There can be no solution to the slum problem until housing becomes a relatively more important part of total

investment. The conditions described here, which are expected to sustain a heavy volume of housebuilding and stimulate additional household formation, should, as a by-product, reduce the need for public expenditures to expand the housing stock.

Summary

The final conclusions to be drawn from these opinions and comments are: (1) mortgage debt is not "too high" now and may even be expected to increase because of continued shifts to home ownership; (2) the historical building cycle is largely a product of inadequate statistical data, but even if it were not, the bases for investing in real estate have changed and the old cyclical pattern cannot be expected to obtain now; (3) the current "boom" is actually relatively less of a boom than were previous housing expansions; (4) continued and even greater house production is required if slums and blighted areas are to be eliminated; (5) the current high volume of housing starts is the product of long-run and institutional shifts in the economy related to real incomes, financing terms, technological progress, and consumer preference changes rather than temporary stimuli; and (6) the current level of house production is not unusual in terms of the adjustments which have taken place in the economy.

Financing Commonwealth Development by Private Means

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FROM TIME TO TIME it happens in the social sciences that cultural patterns established in one area may be quite important for other and more significant developments. Revived talk of the International Finance Corporation which was proposed in the Rockefeller report and which has long been under study by the International Bank for Reconstruction and Development brings into focus an interesting British financial corporation which has been quietly going about its business in a relatively obscure manner. This is the Commonwealth Development Finance Corporation (CDFC), a development institution which British private interests proposed and created.

Ever since Chile began its development schemes with the Fomento type organization, development corporations have become increasingly popular as government tools for getting industries started in underdeveloped areas. Private enterprise, for the most part, has kept somewhat aloof from this type of financial institution. It is true that development corporations often take on the character of mixed enterprises with some sort of participation by private interests, normally on a minority basis. For example, Venezuela's Industrial Bank was originally planned as a fifty-fifty mixture of public and private interests, but was finally established with

60 percent government participation.¹ It is also true that something of a private counterpart to the government development corporation may be found in the open-end investment companies which buy shares in American industry — usually without control motives. But the private interests are normally distinctly subordinate in the mixed development corporation, and the investment company is usually oriented in the direction of the small investor and has little consciousness of a social mission.

Therefore when the now historic Commonwealth Economic Conference of December, 1952, received a proposal from a group of distinguished British businessmen to form a development finance corporation for the Commonwealth, it was readily welcomed as a distinctive contribution.² The British at the time were in the midst of reaffirming their long-term views which had been reached the previous January in the atmosphere of tension surrounding the sterling crisis of the period. They were especially anxious to stress long-term development projects — particu-

¹ International Bank for Reconstruction and Development, *Development Corporations and Related Institutions in Selected Countries*, 1951, mimeographed, p. 36.

² Text of Communiqué, *Labor and Industry in Britain*, British Information Services, X (December, 1952), 169.

larly those which would develop resources and help the Commonwealth balance of payments vis-à-vis the dollar area. Within this framework, the role of the CDFC was envisaged as accelerating financing of projects undertaken by private enterprise through providing or procuring equity capital for more venturesome undertakings. Now investment in equity capital is the same function that differentiates the proposed International Finance Corporation from its potential parent, the International Bank for Reconstruction and Development. A prime reason preventing this corporation from coming into existence has been the reluctance of private interests in the United States to allow an international body to take up equity financing in private companies. Hence the Commonwealth Development Finance Corporation, while serving the special objective of aiding the Commonwealth, does provide a pilot project for equity investments in complex undertakings. British private interests have shown themselves willing to shoulder social responsibility and to experiment with new types of enterprises. With this parallel in mind, it is worth while to examine this British institution for its own sake and for whatever light it may throw on private foreign investment of American capital.

The Corporation's Structure, Objectives, and Operations

The first striking thing about the corporation is its mixed structure. It is a part-public, part-private organization with 55 percent of its £15,000,000 capitalization held by private interests and the remaining "B" type shares subscribed by the Bank of England, itself a

government corporation. However, all the voting stock is held by private interests and the Bank appoints only one director. Hence, in spite of the blessing and substantial participation of the British government, the senior partner is distinctly private. Within the private sector, it may also be looked upon as a marriage of industry and finance. Subscribers to the shares were leading industrial and commercial houses, mining and shipping companies, and numerous financial houses of London's "City." The distinguished governing board broadly reflects the diversity of interests involved. The chairman of the board is the chairman of Shell Petroleum, three other directors come from Lever Brothers, Imperial Tobacco, and South African mining interests, three more from banks and investment companies, and the government director from the Bank of England.

The main objective of the corporation is to provide or procure financial facilities of all kinds to develop the natural and other resources of the Commonwealth. Its primary function is considered to be to help finance development projects undertaken by private enterprise.³ It seeks to provide financing, but will not itself manage the firms in which it invests. Five general criteria have been established for its policy guide on applicants. These are (1) that those applying for funds must be unable to raise the money in the area where the development is to take place; (2) that something has to be provided out of the promoter's own pocket; (3) that as much as can reason-

³ Commonwealth Development Finance Corporation, *Explanatory Memorandum*, April, 1954, p. 1.

ably be expected has been raised through the normal market channels; (4) that expert management is available for the undertaking; and (5) that the project appears to be profitable.

No particular form of capital investment is specified, but in regard to loans, a five- to fifteen-year period is envisaged. Stress is laid on the third condition, because the corporation does not wish to compete with existing institutions. It sees its role as facilitating projects not readily handled in normal channels, for example, where the project is new and untried or where large sums are involved. In this latter type, the CDFC works closely with the International Bank. It can provide the equity financing itself or induce other investors to come forward with equity financing which, in turn, is matched by loans from the Bank.

In addition to the private business type criteria, certain public or social considerations are important. First, the projects selected must contribute to the development of resources in the area. Food and raw materials production is stressed. Second, they must specifically assist in the improvement of the balance of payments of the sterling area — in short, contribute to a solution of the dollar shortage. In a sense, these two are really the same objective, since resource development means the expansion of raw materials (including food) to cut down dependence on imports from the dollar area on the one hand and on the other, to build up exports which the Paley Commission avers the United States will need badly in years to come.

In general, large government-controlled projects are not deemed desir-

able at the moment, though the door is left open for future consideration. Transportation, communications, public utilities, hydroelectric schemes, and other social overhead projects are regarded as better left to government. Nor are funds to be invested in other development corporations because participation in specific projects is the CDFC's objective. It would be best for the development corporation to invest jointly with the CDFC as in the case of the Sui Gas Transmission Company.

This case brings up the present operations of the company. Sui was the first of four investments reported to date (December, 1954). It is a £9,000,000 project to transfer natural gas from Western Pakistan to Karachi along a 350-mile pipeline to provide fuel for industries in an area with limited coal and oil resources. The equity capital amounts to about £4,000,000 divided among the CDFC (£1,000,000), Burmah Oil (£1,000,000), and the Pakistan Industrial Development Corporation and private investors in Pakistan (approximately £2,000,000).⁴ The IBRD has granted a loan, in which British banking interests are participating, for the remainder. The Pakistan subsidiary of Burmah Oil Company will operate the transmission company under a managing agency agreement for twenty years.⁵ When completed, savings of foreign exchange are estimated at an immediate £3,000,000 a year rising to £8,500,000 at full capacity.

⁴ CDFC, *1st Annual Report*, 1954, p. 8; *London Times*, March 25, 1953, p. 11; *Business Week*, August 22, 1953, pp. 102-3.

⁵ IBRD, *9th Annual Report*, p. 17. The importance of the Sui oil field is covered in *Pakistan News*, March, 1954.

The second investment of the Commonwealth Development Finance Corporation was a 5-percent, 15-year loan to the Electricity Supply Commission of South Africa (ESCOM) for £2,000,000 (at an effective issue price of 98.5 percent) for the purpose of increasing the supply of power to the Rand and Orange Free State areas—power needed to expand the production of gold.⁶ Independent of this transaction, the IBRD had loaned ESCOM \$60,000,000 previous to the CDFC loan.⁷

The third project is SAICCOR—South African Industrial Cellulose Corporation. A mixed corporation, capitalized at £6,000,000, in which the British firm of Courtaulds, Snia Viscosa of Italy, and the Industrial Development Corporation of South Africa are participating equally, the purpose of this company is to manufacture pulp by the bisulphite process from eucalyptus grown in plantations in Natal. All pulp manufactured will be sold to Courtaulds and Snia Viscosa. The pulp, estimated at 40,000 tons annually, will substitute domestic production for imports and the pulp sold to Italy will be a new source of exchange for the sterling area.⁸

The fourth project, the Industrial Credit and Investment Corporation of India, is a tribute to the CDFC's basic thinking.⁹ A composite organization in-

volving private interests in Great Britain, India, and the United States, as well as two public bodies, the government of India and the IBRD, the structure of the organization is modeled after the structure of the CDFC itself. Of the initial capitalization of \$36,350,000 (authorized capital, \$52,500,000), private investors control all of the \$10,500,000 voting equity. Paralleling the role of the British government in the CDFC, the government of India has invested 75,000,000 rupees (\$15,750,000) taken from FOA counterpart funds, receiving special stock not having rights to vote or to receive dividends, but having representation on the board of directors. The United States government through the Foreign Operations Administration may be considered a participant by having approved the use of the counterpart funds for this purpose. Lastly, the IBRD has agreed to make a \$10,000,000 loan to the new corporation.

The parallel is still maintained in the character of the private interests involved. Again there is a fusion of interests in the private sector, only this time private interests from three countries are involved. India, with a \$7,350,000 commitment, has a group of five top-level industrialists and financiers handling her share. The United States investors are the Bank of America, Rockefeller Brothers, Olin Mathieson Chemical Corporation, and Westinghouse Electric International Corporation, who have taken \$1,050,000 among them. The British group, with a share of \$2,100,000, includes some Eastern exchange banks, several insurance companies and industrial con-

⁶ CDFC, *1st Annual Report*, 1954, p. 9.

⁷ IBRD, *9th Annual Report*, p. 20.

⁸ CDFC, *1st Annual Report*, 1954, p. 9.

⁹ *New York Times*, November 28, 1954, Section III, pp. 1 and 7; *ibid.*, December 23, 1954, p. 30; *Indiagram* (Embassy of India, Washington, D. C.), December 24, 1954, p. 3.

cerns, and the Commonwealth Development Finance Corporation. The board of directors reflects this fusion of interests, having five directors from India's private interests, one American director, and two British private directors, one of the latter being J. B. Beevor, an insurance company executive who is also managing director of the CDFC.

The Industrial Credit and Investment Corporation of India is by far the most important project in which the CDFC has taken a share. This company, which took two years to arrange, will undoubtedly play a very important role in stimulating lagging private investment in what is probably the most important underdeveloped country in the free world.

Significance of the Corporation

Although it is somewhat early to examine this concern in detail, the importance of the subject makes even the general outlines, however faint, take on considerable significance in view of its being an investment corporation which mainly represents private interests.

On the negative side, the corporation is relatively small. Viewed from American eyes, £15,000,000 (\$42,000,000) capitalization does not seem likely to make much impression on the problem. The distinguished Australian, Viscount Bruce, who was one of the founding fathers of the corporation, was critical on this point. He is quoted as saying, "we aren't thinking big enough or moving fast enough."¹⁰ However, the

ideal concept which seems to have prevailed is that of a small but venturesome revolving fund whose function would be to "nurse the shares which it acquires" for two or three years and then place them at a profit with other investment institutions.¹¹ The small size of the corporation is also offset by the dual concept of the corporation as both a financier and a locator of financial facilities. The board's distinguished membership makes possible opportunities for interesting other investors, especially American. Lord Bruce himself acknowledged this possibility in a recent address.¹²

Another criticism which may be made is the slowness in finding projects. In almost two years of operations the corporation invested in only four projects. This is due in part to the fact that the corporation is not yet well known and in part to the high selectivity exercised in choice of projects, resulting from the stringent public and private criteria. It is also, however, a result of a calculated policy which seeks to avoid any competition with the London money market. The CDFC has made it very clear that it is quite prepared to wait for some time before its role is understood.¹³ Moreover, the character of its first three projects exhibits a dubious "financial prudence" — to borrow and adapt the famous Keynesian

¹⁰ *Business Week*, August 22, 1953, p. 102.

¹¹ *Financial Times*, London, January 28, 1954, p. 1.

¹² Speech before the American Chamber of Commerce in London, quoted in *Business Week*, August 22, 1953, p. 103.

¹³ *Financial Times*, London, January 28, 1954, p. 1.

term. Excluding the India finance company, of £5,000,000 thus far committed, only 20 percent is in equity capital against 80 percent loan, and the ESCOM loan was made to a government agency backed by assured revenues. Venture capital aspects of this corporation have not proved very venturesome thus far.

Despite the modesty of size, slowness of movement, and overprudent operating policy, the CDFC is a notable undertaking. This corporation is the businessman's specific contribution to development. It stresses the need of "sound" projects under good management, making their contribution to the vital over-all objective of strengthening sterling. It is unfortunate that the thinking must be of a mercantilist character, each project being calculated on its contribution to foreign exchange savings or earnings, but this is the realistic approach required by a dollar-short world. With the prognostications of Colin Clark and the Paley Commission on the importance of primary production in mind, the CDFC emphasizes this type of undertaking. Yet the Sui investment indicates it is not adverse to projects facilitating industrialization, providing savings of foreign exchange for the whole sterling area result.

But its message is also important outside the Commonwealth. In a broad sense, it is private enterprise responding to the challenge of economic development of non-European peoples, moving—perhaps somewhat ponderously—in the direction of accepting new

things. Notable indeed is the breakdown of barriers in the sponsorship of the corporation. The traditionally separate divisions of industry, commerce, and banking have pooled resources. Private interest has combined with government capital, though a more active government role might have been desirable. However, the way the top personnel move back and forth between the corporation and government posts points to close association with the government. In their investments too, they have been quite ready to participate with government institutions. They take their cues from the IBRD, an international institution, and they have participated with two development corporations and have made a loan to a publicly owned agency. They stand on no doctrinaire moralization as to what government's role should be.

What is the meaning for Americans in this undertaking? On a direct level, the British explicitly provided, as an excuse for keeping it small, for the indoctrination of American investors as one of the objectives of their corporation. The British, of course, have more familiarity with local conditions in their area. American investors undoubtedly have hung back in the past because of unfamiliarity with sterling area conditions. The CDFC can serve to reassure American investors and lead them along unfamiliar paths. Indeed, the participation of American investors in the India investment corporation, while of token proportions, indicates that the CDFC has already succeeded in this objective. But on a more subtle and

important level, the CDFC provides a service to Americans. Here is a pragmatic approach to government-business relationships in a very important area. Perhaps no factor has held up the International Finance Corporation proposal more than the reluctance to use

public moneys for investment, especially equity investment, in private enterprises. These stereotypes of what is or is not suitable for government and business are outdated. This British company, whatever its shortcomings, is a harbinger of things to come.

Books Reviewed

Big Enterprise in a Competitive System.

By A. D. H. Kaplan (Washington: The Brookings Institution, 1954, pp. xii, 269. \$4.00)

This volume is an outgrowth of an investigation initiated by the Brookings Institution in 1947 concerning the place of big business in the American economy. The chief aim of the study is said to be "to explore those aspects of big business participation in American industry that may reveal whether it is or is not compatible with the objectives of competitive private enterprise" (p. 1). An introductory chapter contains a good, compact summary of the history of the merger movement and of fluctuating public attitudes toward monopoly as reflected in legislation and leading Supreme Court decisions. There follows a chapter entitled "The Rationale of Competitive Enterprise" which is devoted to an elementary discussion of the technological and organizational factors which have resulted in the overwhelming predominance of monopolistic competition or oligopoly in industrial markets. It is asserted that "The case for the competitive system must rest on its ability to satisfy a combination of objectives, no one of which the American people would be willing to forego" (p. 56). These objectives include a wide choice of goods and services, extensive innovation, and low costs achieved by large-scale operations. It is concluded that since the attainment of these objectives is seldom consistent with pure competition, the proper norm for judging big business is whether it is

consistent with so-called "workable competition," characterized by freedom of entry into markets by new firms, freedom of action by firms already in the industry without coercion by a dominant firm, equality of bargaining power between customers and suppliers, extensive research and innovation, and the multiplication and improvement of products. The author says, "It is to these factors that we must look in judging the degree of competition in modern business and in judging whether or not the basic requirements of a free society are thereby being served" (p. 59).

The remainder of the volume, to which the foregoing chapters are introductory, is divided into two parts. In the author's words, "the first deals with the quantitative measurements for interpreting the position of big business in the national economy; the second with the evaluation of the performance of big business — the effects of size and product leadership on business motivations and on the forms of competition which they tend to emphasize" (p. 4). Five chapters are devoted to the first of these topics. The available evidence relating to industrial concentration is extensively reviewed and it is emphasized that the degree of concentration in output differs from the degree of control over the markets in which the output is sold. Concerning this the author states, "Given the tempo of product and process realignments that is evidenced even in the limited comparisons of the data for successive censuses,

the current holding of a high percentage of a product or industry by a few dominant firms may no longer be indicative of power to control the disposition of the product or its competition" (p. 111). Data are presented which show that the percentage of the total assets of all industrial corporations held by the 100 largest industrial corporations increased from 24.6 percent in 1909 to 26.7 percent in 1948, but that the percentage of the profits of all industrial corporations received by the 100 largest, both before and after taxes, declined. A series of tables and charts is presented which shows the turnover among the 100 largest industrial corporations in various years. Of the firms in the list of the 100 largest in 1909 only 36 remained in that list in 1948, and of these, five were not on the list in one or more intermediate years. It is concluded that these data show that there is a "continuing challenge to the established position of current industry leaders," and that although this evidence of mobility cannot dissipate concern with regard to increasing concentration or the possible abuse of great financial resources, it does "indicate that we are not justified in identifying increase of financial resources of large-scale enterprise with net decline in the scope and vigor of competition" (p. 144).

Three chapters are devoted to the second major division of the study. With respect to price policies it is pointed out that "stable formula pricing and aggressive pricing to force volume may both be found within big business" (p. 165), that price inflexibility has not increased during the

period for which the relevant data are available, and that against any tendency of large size and fewness of competitors to reduce price competition in the short run must be set the accomplishments of big business in the way of innovations which produce major price declines in the long run. Considerable attention is given to what are called internal and external competitive pressures upon big business. Among the internal pressures are the rivalry among division managers of multi-division enterprises, the pressure from the sales department for price and product changes that will stimulate sales, and the pressure from other departments to reduce costs. Among the external pressures are the existence of actual and potential substitute products, innovations which cross product and industry boundaries, the efforts of large distributors to promote private brands, and the ability of large buyers to manufacture for their own use. A chapter is devoted to the nature and significance of various kinds of integration — horizontal, vertical, and circular. The anti-competitive possibilities of integration are recognized, and it is admitted that "enforced dissolution may be the only step available when integration, whatever the motives, has gone so far as to weaken the force of competition itself. But it is clear that enforced dissolution is justifiable only as a last resort" (p. 226).

In the reviewer's opinion, the present volume breaks little new ground but it is a very clear, persuasive, and comprehensive presentation of a point of view toward the problem of industrial monopoly popularized by the recent

works of Galbraith and Lilienthal. As the foregoing summary suggests, those who take this position see nothing objectionable in size or concentration per se and would limit the application of the antitrust laws to those enterprises which did not meet the tests of workable competition as defined earlier. However, as a practical matter, such leading students as Corwin Edwards, Mund, Machlup, and Stocking and Watkins see a much greater need for resort to the antitrust laws, even in terms of the workable competition thesis, than does the Kaplan-Galbraith-Lilienthal school. Both viewpoints must be studied by those who wish to reach a balanced judgment concerning the important and unsolved problems of public policy involved.

ROBERT W. HARBESON

Price Making and Price Behavior in the Petroleum Industry. By Ralph Cassady, Jr. (New Haven: Yale University Press, 1954, pp. xx, 353. \$4.00)

Dean Donham, in the first issue of the *Harvard Business Review* (1922), wrote that "The task of developing business theory scientifically is first, the recording of facts; second, the arrangement of these facts into series and relationships; third, the development of generalizations which can be safely made only upon the basis of such recorded facts." Professor Cassady has had an opportunity, infrequently granted to academicians, to gaze upon and dig into the inner workings of a large and important industry at all levels of its operation. He has used this

chance well in developing the most comprehensive, detailed, and authoritative description of pricing in the oil industry known to this reviewer. His facts are logically and clearly presented. His generalizations, drawn from those aspects of pricing he studied, are, for the most part, quite appropriate. The study proceeds and is completed, however, with only minor reference to domestic production controls over crude oil output and with no attention to international impediments to the free flow of oil. An opportunity for a much deeper understanding of competition and pricing in the oil industry is therefore missed.

This study is the result of a project initiated in 1949 by the American Petroleum Institute. The petroleum industry itself felt that scholars should be encouraged and permitted to collect and analyze facts about the economic structure and behavior of the industry. Accordingly, the industry placed a fund at the disposal of the Yale University Press to undertake such work. Professor Ray B. Westerfield became Chairman of the Editorial Board which includes three other distinguished economists and two oil men. The Board chose three areas of the industry for study. They were production and conservation, integration, and prices and price mechanisms. The study reviewed here is the first of the three completed. Both the Board and the authors chosen to make the studies have been assured complete freedom of inquiry and publication of results. The Board serves in an advisory capacity to the authors.

Cassady's study is designed as "An all-out attempt . . . to present an ac-

curate, realistic, and objective view of price mechanisms in this industry" (p. 1). This is no small task. The industry has some 2,600 products. No company is completely representative of all, individual officials have for the most part knowledge of only a segment of the story, semantic problems exist in the industry as elsewhere, the industry is extraordinarily complicated, and other formidable problems confront any careful analyst.

The study concentrates on gasoline, middle distillates (including Diesel fuel), and residual fuel. These products account for more than 80 percent of the physical volume of the industry and about 75 percent of the dollar shipments. The main emphasis in the study is on gasoline. This product accounts for almost half the dollar shipments of the industry. Many of the hardest pricing problems also center on this item.

The first third of the book is devoted to an analysis of the nature of petroleum products, the general dynamics of competition, and pricing problems in the industry. The discussion covers such topics as rivalries and market strategy among firms, the structure of product distribution, actual competitive problems, elasticity of demand, joint costs, marginal pricing, and price leadership. Most of the remainder of the book is concerned with pricing of particular products. Price-reporting mechanisms, company official responsibilities for pricing, price differentials, variations in posted prices, initiation of price changes, price negotiations, product trading, pricing and the antitrust laws, rebranding, and retail price wars are

examined. This part of the volume is exhaustive — and exhausting. To those seeking a minutely detailed picture of price making in the industry for the products covered, however, the thorough compilation will be a virtue. Professor Cassady has succeeded in condensing the most relevant facts out of a mountain of complexities. Two short concluding chapters complete the presentation.

Cassady concludes that competition is strong in the industry, that firms must be aggressive to survive, and that vendors typically behave like competitors. Indeed, he observes, "Competition may actually be considered too intensive in the petroleum industry" (p. 341).

The author, applying Professor Merson's well-known competitive behavior criteria to the industry, finds (1) that buyers have alternative sources of supply in most markets, at all distribution levels; (2) that the main motivating force, generally speaking, is individual competitive effort; (3) that there is a substantial degree of freedom of entry by rival competitors at all distribution levels in the industry. But Cassady is not at all sure just what to conclude about the degree of control exercised in given markets by large sellers.

In dealing with the problem of competition and pricing, public and private crude oil production controls should not be pushed into the background. Cassady does this. He does not ignore these controls (pp. 111-14), but by concentrating attention almost exclusively on rivalry within price ranges he loses sight of the impact of such controls on the entire structure and level of prices

of petroleum products. Production controls are also, of course, an important factor in any consideration of the state of competition in the industry.

Most crude-producing states cooperate in controlling supply. The United States Bureau of Mines makes monthly estimates of market demand for crude oil by states. Oil proration authorities are guided by these figures in allocating production among the states. Shipment of oil in excess of quota limitations is contrary to Federal law. In addition to domestic output allocations are questions concerning restrictions in international trade among some major oil companies which the Department of Justice raised in a suit filed in 1953. The case is still pending.

Our understanding of pricing and competition in the industry would have been enhanced by a full consideration of domestic and foreign crude-production control programs to the extent that they affect domestic price. Beyond this, however, the author has done a real service in developing a comprehensive statement of rivalry pricing in the oil industry. The book will undoubtedly stand for a long time as an authoritative study of this aspect of the industry.

GEORGE A. STEINER

The Fifth Freedom—Freedom From Taxation. By Butler Sheldon, Jr. (New York: Library Publishers, 1954, pp. xiii, 111. \$2.75)

The title of this little volume is appealing because everyone would like to be freed from taxation provided necessary governmental services could be financed in a less burdensome and more equitable manner by alternative

measures. By the same token, the title is one which is likely to arouse suspicion in the minds of disciplined economists. It has a panacean smack but before we pass judgment let us first examine the proposal.

The basic objectives of the scheme advocated by the author are:

1. To rid ourselves of the burden of taxation which takes from 1½ to 2½ days of labor each week from the pay of the laboring and clerical men and women to support the government.
2. To pay off our national debt of approximately \$260 billion at once and relieve the people of the taxation levied to pay the interest charges each year, which if figured at only 2 percent amount to something more than \$5.2 billion.
3. To bring about an era of prosperity such as we have never enjoyed in our land except during war years when money was so plentiful that it was without too much meaning.

As a means of attaining the above objectives, the author recommends first the establishment of an international gold standard and creation, by agreement with other countries on the ratio of currency to gold, of the necessary money to pay off the public debt. In order to avoid inflation from using the newly created money to retire the national debt directly, the plan calls for loaning the \$260 billion to state governments for the construction of self-liquidating state projects such as toll bridges, toll roads, and hydroelectric facilities. In return for the Federal

advances from the newly created money, the state agencies would issue 4-percent, 30-year amortized bonds, with the principal and interest guaranteed by the Federal government. These securities, in turn, would be used by the Federal government to pay off present holders of United States securities. The principal and interest on the state securities would be serviced from the earnings of the various state projects, and the debt would be fully retired at the end of 30 years.

To avoid inflation, the plan provides that the full amount of the \$260 billion in new money should not be made available for state self-liquidating projects at one time. Rather, \$26 billion would be released each year over a ten-year period which, together with the transfer of securities mentioned earlier, would result in retirement of the present Federal debt in ten years. Retirement of the Federally guaranteed amortized state debt, it will be remembered, would require 30 years.

The author argues that the expenditure of \$26 billion annually on state construction projects would "provide jobs for all" and assure a high level of business activity. Federal taxes could be reduced immediately by the amount of the interest charges that we are now paying on United States securities, or approximately \$6 billion annually. A further tax reduction could be achieved, the author says, by issuing \$90 billion more in money than would be needed to retire the present national debt (\$260 billion) and using this sum to cover the cost of rearmament. Upon retirement of the state bonds, a still further substantial reduction in taxes

could be made, it is contended, by applying the profits of the state projects toward financing public services.

Space does not permit a full discussion of the weaknesses and actual dangers in the plan proposed. It must suffice merely to mention the major shortcomings of the proposal.

In the first place, most state construction projects do not produce a direct monetary return and hence are not adapted to a self-liquidating type of financing. It is thus doubtful whether the large sum of \$26 billion annually for a ten-year period could be used to maximum social advantage on revenue-producing projects. Even if there were suitable projects, adoption of the proposed plan would place the burden of retiring the national debt solely upon users of the services. Charges for the services of state enterprises, moreover, are customarily proportional and are therefore more burdensome upon lower income groups than upon higher ones. Any excess of charges over costs is especially burdensome upon low-income users. The present tax system, notwithstanding its defects, is sharply progressive for families with incomes in excess of \$7,500 annually. Substitution of a regressive system of public charges for a system of progressive taxes cannot be defended as a means of debt retirement.

The expenditure of \$26 billion annually over a ten-year period for self-liquidating state projects would have a highly inflationary effect. Witness the inflationary effects of war borrowing during the past decade and a half. All of the citizens would feel the impact of the inflation and its far-reaching dis-

tortions. It is conceivable that unemployment might be of sufficient magnitude during two or three years of the next decade to warrant the expenditure of substantial sums for public works. It is unrealistic, however, to assume that the expenditure of \$260 billion during the next ten years will be necessary or desirable. The expenditure of \$90 billion of newly created money over the next few years for rearmament would add further fuel to the inflationary fire.

Exchange of the proposed 30-year Federally guaranteed state bonds for existing direct obligations of the Federal government would be difficult, if not impossible. Voluntary exchange would be unacceptable to the banks and compulsory exchange might not be constitutional. The commercial banks currently carry large quantities of short-term United States securities as secondary reserves and would not be willing to exchange them for long-term amortized issues. The Federal Reserve banks, moreover, carry large quantities of short-term securities for the purpose of controlling credit through open market operations. Some of the proposed 30-year amortized bonds would have early maturity dates, but the total amount of such issues would be far short of the needs of the banking system.

As previously explained, adoption of the author's proposal would have a highly inflationary effect during the ten-year period when \$26 billion would be spent annually on state construction projects. The method proposed for retiring the state bonds would likely have a strongly deflationary effect during

the last twenty years of the plan. Deflationary forces would be released to the extent that moneys collected from users of state enterprises were applied to the retirement of bank-held state bonds. A reduction in bank holdings of government securities, without a corresponding expansion of private loans, would reduce the supply of money and decrease national income.

The scheme proposed by the author is cumbersome, inflexible, and impracticable and would do more harm than good. We are already adequately equipped with tested devices for fiscal control, monetary control, and debt management. These devices are far superior to those here proposed.

H. K. ALLEN

Trade, Aid, or What? By Willard L. Thorp (Baltimore: The Johns Hopkins Press, 1954, pp. 224. \$4.50)

This book is an outgrowth of a conference of experts on international economics, from government, business, and academic life, which took place in the summer of 1953 under the auspices of the Merrill Center for Economics. Willard L. Thorp, the director of the Center for Economics, has, in his own words, tried "to recapture as many of the considerations, complications and evaluations that arose during the conference as possible."

The chief merit of this work is its complete coverage of the numerous problems encountered today in the international movement of goods, capital, and technology, the many solutions to these problems which have been tried, or at least discussed, and their potential advantages and drawbacks.

Two main aspects of the general field of international economics are treated in the book. The first is that of trade and payments, important mainly to industrialized and other advanced countries which are confronted with the necessity to "finance a volume of imports . . . that is believed to be necessary or desirable if the economy in question is to continue to operate in certain ways. . . ." The achievement of this aim was made extremely difficult for Western European countries by the ravages of the first and second World Wars, as well as by more long run developments, chiefly the expansion of United States foreign trade at a rate far greater than the expansion of total international trade, and the cyclical fluctuations in the terms of trade between industrial and raw material producing countries.

The ways of dealing with these problems that receive particular attention are aid, trade controls, increasing production and exports, exchange rates and exchange controls, and attempts at closer economic collaboration between groups of countries, such as the sterling area and the European Payments Union. (One of the rare omissions of the book occurs in a complete lack of reference to the Benelux Customs Union.) Other means, such as emigration and commodity agreements, are discussed more briefly.

The second area dealt with in Mr. Thorp's book is that of international investment, which is most important to underdeveloped countries which possess no real possibility of accumulating significant amounts of capital of their own. The private flow of capital is very

small today, compared both with that of the nineteenth century and with current needs. This reluctance of Americans to invest abroad — and they are today by far the greatest potential source of funds — is caused partly by the relatively small differential in returns from foreign as against domestic investment and partly by the increased risks caused by political and social uncertainty, the threat of sudden termination of convertibility, and an often arbitrary treatment of the rights of foreign investors.

Another important consideration is the readiness or ability of the underdeveloped country to put capital to successful use in promoting its economic progress, which depends on many diverse factors, such as the state of technological knowledge, the general level of education, natural resources, occupational mobility, and back of all these, tradition and the general attitude toward change and what we generally refer to as progress.

To fill the gap left by diminishing private investment in other countries, there has been a trend toward greater activity by national and international public bodies. Whether this is looked upon as a desirable development or as a dangerous expedient increasing the importance of government in one more economic province, there can be no doubt that it is likely to persist for some time. The main reason for this is the great political importance of helping to improve social and economic conditions in the underdeveloped countries sufficiently to deter them from joining the communist bloc.

There are surprisingly few points at

which one finds fault with the generally excellent exposition in this book. One of these is in Chapter II, which compares the nineteenth-century adjustment mechanisms of exchanges, interest rate, and gold movements with the twentieth-century mechanism of controls. There is no indication of the main difference between the two—that controls almost invariably involve a downward adjustment of trade when an unbalanced situation is to be corrected.

In the section on "Trade, not Aid" in the same chapter, several ways of achieving the transition to trade are considered, but all of them disregard the very real contribution that continuing increases in production in the deficit countries would make.

Chapter V, on trade liberalization, presents a fairly detailed discussion of what seems to be little more than a crank method for liberalizing United States trade policy. The suggestion is that whenever the free imports of any commodity equal a fixed percentage of the United States production of that commodity, the full duty would become applicable. This is, perhaps, a minor point to quibble about, except that it is

indicative of a general tendency to include virtually every possible opinion and point of view on every subject, often with apparent disregard of its real importance or usefulness. This is, I suppose, an almost unavoidable shortcoming of a book that is basically a summary of a group discussion, as is the fact that no well-reasoned or consistent point of view emerges in this work.

Last, but not least, the question arises as to what type of audience this book is aimed at. There is great need for a book that will serve the many people engaged in or concerned with the international field today. It is unfortunate that while the work is interesting and highly informative, it is somewhat too technical to permit understanding by the nonspecialist. This is all the more regrettable since relatively minor changes in exposition and terminology would have remedied this shortcoming to a large extent. As it is, Mr. Thorp's book will prove highly useful to the more limited group possessing enough background in theory to cope with the usual jargon of the economist.

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